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Report to the Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate

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INTERSTATE BANKING

Experiences in Three Western States

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The Honorable Donald W. Riegle, Jr.
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

Dear Mr. Chairman:

This report responds to your request that we review the potential impact of lifting restrictions on interstate banking. Supporters of a nationwide interstate banking law have argued that geographic restrictions no longer make sense in today's integrated financial and credit markets and, further, undermine the ability of U.S. banks to compete domestically and internationally. Opponents, however, feared that relaxing geographic restrictions could result in a concentration of economic power among a relatively small number of banks. Given these conflicting views, you asked us to review the experiences of some states that have had interstate banking for some period of time. Congress recently passed legislation lifting some restrictions on interstate banking and branching. On September 29, 1994, the President signed into law the Interstate Banking and Branching Efficiency Act,[1] hereafter termed the Interstate Banking Efficiency Act.

In our November 1993 report,[2] we reported on interstate banking and its (1) potential effect on the banking industry's structure nationwide; (2) implications for the safety and soundness of the banking industry, the Bank Insurance Fund[3], and the economy; and (3) associated risks and ways to minimize them. In that report, we said that the best way to minimize the potential risks to the quality and availability of banking services arising from interstate banking is to ensure that markets remain competitive through vigilant antitrust enforcement and that laws and regulations governing credit availability are enforced.

This report discusses the experiences of three western states—California, Washington, and Arizona—which have operated in an environment permitting interstate banking and in-state branching. Specifically, we evaluated their experiences to determine whether these geographic laws

[1]P.L. 103-328.

[2]Interstate Banking: Benefits and Risks of Removing Regulatory Restrictions (GAO/GGD-94-26, Nov. 2, 1993).

[3]A deposit insurance fund operated by the Federal Deposit Insurance Corporation (FDIC). This fund generally insures deposits in banks up to $100,000 per account in interest and principal.

have had any effect on the (1) market share and number of large banks,[4] (2) viability of smaller banks,[5] and (3) availability of credit to small businesses.[6] This report provides useful information for Congress and regulators on the potential impact on states of lifting certain geographic restrictions.

Background

Prior to the passage of the Interstate Banking Efficiency Act, Congress largely had ceded to the states the power to determine how bank holding companies could branch within states or expand across state lines. Generally, states could permit a bank holding company to expand by (1) interstate banking—acquiring bank subsidiaries outside its home state; (2) interstate branching—establishing branches outside its home state; and (3) in-state branching—acquiring branches throughout all or part of its home state.[7]

Section 3(d) of the Bank Holding Company Act of 1956, commonly known as the Douglas Amendment, prohibited bank holding companies from acquiring a bank subsidiary in another state unless the state where the acquired bank was located specifically permitted such acquisitions. The Douglas Amendment had two central purposes: (1) to help alleviate concerns that economic power could be concentrated among a relatively small number of nationwide banking institutions and (2) to keep national and state-chartered banks on an even footing by giving states, not the federal government, authority over interstate banking. The McFadden Act of 1927 generally barred interstate branching for all national banks and all state-chartered banks that were members of the Federal Reserve System.[8] A national bank was allowed to branch within its headquarters state to the extent that state law authorized branching by state banks.

[4]In California, we considered large banks to be those with more than $10 billion in assets, from December 1984 to June 1993. In Washington and Arizona, however, we were not able to use this categorization because only one bank of this size existed in each state in most of those years. Nonetheless, banks with more than $1 billion in assets in these states had a statewide presence similar to those with more than $10 billion in assets in California. We therefore considered large banks in Washington and Arizona to be those with more than $1 billion in assets.

[5]Smaller banks refer to those with $1 billion or less in assets in all three states.

[6]The Small Business Administration (SBA) defines small businesses as independent firms employing fewer than 500 workers.

[7]Bank subsidiaries are separately chartered and regulated institutions that are part of bank holding companies. Bank branches are offices of the bank and, as such, do not have separate capital requirements.

[8]The Federal Reserve System is the central banking system in the United States, consisting of 12 district banks and the Board of Governors. National banks are required by law to own stock in the Federal Reserve bank in their district. State-chartered banks have the option of becoming members or remaining nonmembers.

Over time, most states relaxed their interstate banking laws by enacting laws authorizing out-of-state bank holding companies to acquire in-state banks and bank holding companies. Many of these state laws had nationwide triggers, which allowed holding companies from anywhere in the country to acquire banks in those states. By year-end 1993, all but one state—Hawaii—permitted some form of interstate banking. Most states had laws permitting in-state branching. However, only eight states permitted interstate branching, and only for state-chartered Federal Reserve nonmember banks.

Although most states had relaxed their interstate banking laws, some bankers urged Congress to enact a nationwide banking and branching law to facilitate the banking industry's ability to compete. They argued that without a nationwide law, banking companies must deal with each state separately, and that this was an expensive and inefficient process. Proponents of a nationwide interstate banking and branching law believed that removing restrictions would strengthen the banking industry and benefit customers by (1) increasing competition and geographic diversification, (2) reducing the need for customers to maintain separate accounts in different states, and (3) offering a wider range of products and services that are generally associated with larger banking companies.[9] Opponents feared such actions would lead to adverse effects such as excessively concentrating assets and deposits under large banks' control, impairing smaller banks' survival, and reducing small businesses' access to credit.[10]

Congress passed a nationwide interstate banking and branching law, the Interstate Banking Efficiency Act, during the second session of the 103rd Congress. This act authorizes the Federal Reserve Board, effective 1 year from the date of enactment, to permit adequately capitalized and adequately managed bank holding companies to acquire banks located anywhere in the United States outside of the acquirer's home state without regard to state laws. In addition, the act provides for interstate mergers and branching by FDIC insured banks in states where such activity is permitted. First, beginning June 1, 1997, banks may merge across state lines so long as the states involved have not enacted laws which expressly prohibit interstate mergers before that date. Interstate mergers earlier than

[9]For a further discussion of the benefits of interstate banking and branching, see GAO/GGD-94-26.

[10]Opponents of lifting geographic restrictions have other concerns such as increased fees and deteriorating customer service that may result from reduced competition. However, we have addressed some of these concerns in our report GAO/GGD-94-26. For a discussion of how geographic deregulation affected the three states we reviewed in this report, see appendix II through appendix IV.

June 1, 1997, are allowed in states having laws that expressly allow them. Second, out-of-state banks may acquire branches, without acquiring the bank itself, but only if the state where the branch is located permits such transactions. Finally, the act permits national and state nonmember banks to enter states for the first time through the establishment of a new branch, if the state has a law expressly permitting such branching.

Results in Brief

Although states' interstate banking and in-state branching laws provided large banks with the opportunity to expand, the experiences of California, Washington, and Arizona indicated that such geographic deregulation[11] did not necessarily result in a more concentrated industry.[12] One reason for the lack of significant additional consolidation[13] may have been that the banking industry in these states was already highly concentrated, reflecting previous consolidation.

In all three states, the experience of large banks was mixed; some grew, some declined, and others were acquired. On balance, large banks held no greater share of the three states' markets in June 1993 than they did at the end of 1984. However, both federal and state regulators became concerned about undue concentration when the two largest bank holding companies in the western states—BankAmerica and Security Pacific—requested approval for a merger. Before approving the merger, regulators proposed the divestiture of a number of branches.[14]

During the period December 1984 through June 1993, smaller banks, whether owned in-state or by out-of-state bank holding companies, continued to play an important role. They frequently were among the most

[11]Geographic deregulation is a general term that refers to interstate banking, interstate branching, and/or in-state branching.

[12]Concentration is measured by the amount of business handled by the largest banking companies within a market.

[13]Industry consolidation is characterized by a greater concentration of assets among the largest banking companies in the country. For more information on the concentration of the banking industry nationwide, see GAO/GGD-94-26; "Concentration in Local Markets," Stephen A. Rhoades, Economic Review, (Mar. 1985); "Trends in Banking Structure Since the Mid-1970s," Dean F. Amel and Michael J. Jacowski, Federal Reserve Bulletin, (Mar. 1989); and "Interstate Banking: A Status Report," Donald T. Savage, Federal Reserve Bulletin, (Dec. 1993).

[14]A divestiture refers to the sale of an asset to achieve a desired objective. A bank may sell branch offices or an entire operating division, for example, to cut expenses or carry out its business plan for long-term growth.

profitable banks as measured by return on assets[15] and, despite geographic deregulation, either gained additional market share or regained previously lost market share. In Washington and Arizona, this was caused in part because some smaller banks—especially in Arizona—were acquired by out-of-state bank holding companies.[16] By mid-1993, Washington's in-state smaller banks had regained most of the market share previously lost to out-of-state banks. Their market share rose to 17.6 percent from a low of 13.8 percent in 1989. However, in Arizona, smaller banks that were owned out-of-state gained market share at the expense of in-state smaller banks, with the latter's share falling from 11.2 percent in 1985 to 6.8 percent in June 1993.

Although over the period of our review, the market share of all smaller banks as a group did not generally decline, the market share of the smallest banks—those with less than $100 million in assets—did decline. In Arizona and Washington, most of this market share was lost to other small banks (those with assets from $100 million to $1 billion). In California, the smallest banks' lost market share was generally gained by small or midsized banks (those with assets between $100 million and $10 billion).

According to some bankers and focus group participants[17] we interviewed, large banks were credited with increasing credit availability to those small businesses in the three states that met the large banks' lending criteria. Other bankers and participants mentioned, however, that the practices of centralizing and standardizing loan decisions, common to large banks, could result in some small businesses having difficulty obtaining credit in markets where there are few alternatives to large banks.[18] They told us that the standardization of loan criteria, coupled with the removal of authorization for loan decisions by local bank officers knowledgeable about the community, impaired small businesses' access to credit. However, bankers from large banks told us that centralizing and

[15]Return on assets is calculated by dividing net income by total assets. This indicates how profitably a financial institution's assets are employed.

[16]A corporation that controls at least one bank.

[17]In each state, we met with three or four focus groups made up of administrators of nonprofit loan funds, individuals who helped businesses obtain bank financing by assisting them with loan applications for loans guaranteed by the states or the SBA, SBA officials, directors of city and county economic development departments, and former bankers. For a discussion of the benefits and limitations of these group discussions, see appendix I.

[18]Under a centralized and standardized system, loan officers working in a central location make loans according to standardized financial criteria. This system may depersonalize the relationship between the loan officer and borrower, making it difficult for the loan officer to take into account relevant credit information that is not captured using standardized criteria.

standardizing their bank operations had allowed them to become more efficient and in turn serve many more small businesses.

Some bankers and focus group participants attributed credit difficulties to a decline in the number of small banks or a change in lending emphasis from commercial lending to consumer lending by some banks that were acquired. They viewed smaller banks as strong providers of credit in the three states we visited even though they said these banks did not have a large presence in some inner cities and rural markets.

As we said in our November 1993 report, vigilant antitrust enforcement of the banking industry is necessary to ensure that any adverse impact of consolidation on certain segments of the small business sector is minimized. Such actions should increase the likelihood that small business loan needs are met.

The Three States Offer a Contrast

The three states we focused on—California, Washington, and Arizona—allowed us to examine interstate banking and in-state branching provisions in a variety of banking and economic environments. According to many observers, California's large size, diversified economy, and relatively consolidated banking industry provides one example of how the nation might fare under nationwide banking and branching. California law has permitted in-state branching since the early 1900s and interstate banking since 1987. Several large California banks have branched throughout the state, but out-of-state banks have no significant presence.

In contrast, once Washington and Arizona introduced interstate banking, out-of-state bank holding companies acquired the majority of the banking assets in each state. Washington had some restrictions on in-state branching until 1985 and passed interstate banking in two phases. First, in 1983, out-of-state banks were allowed to purchase failing in-state banks in Washington. Second, in 1987, out-of-state bank holding companies were permitted to purchase healthy Washington banks as long as the state where the acquirer was headquartered permitted reciprocal arrangements for bank holding companies headquartered in Washington. Arizona has had in-state branching since the 1870s and interstate banking since 1986.

California, the most populous state in the nation, was considered economically sound until the early 1990s. Washington is a middle-sized state that since the mid-1980s has, for the most part, exhibited steady but more moderate economic growth than California. Arizona, also a middle-sized state, has in recent years experienced rapid economic growth followed by an abrupt downturn. All three states had relatively high rates of economic growth from 1984 through 1990. California's and Washington's gross state products grew 60 percent and 58 percent, respectively, while the national gross domestic product grew 46 percent during this 6-year period.[19] Despite its economic problems, Arizona—whose gross state product grew by 52 percent—also grew at a faster rate than the nation as a whole. Although its real estate market suffered greatly, the remainder of Arizona's economy continued to grow.

The three states fared differently in the national recession that began in 1990. California began to suffer from the effects of the recession in 1990; as of year-end 1993, economists saw its recovery lagging behind the nation's. Washington, in contrast, did not begin to suffer the effects of the recession until mid-1991, and economists did not expect the recession to be as prolonged or as deep as it was in California. Finally, Arizona had experienced economic problems well before the national recession began in 1990. In the late 1980s, Arizona's economy was severely hit by a variety of factors, the most frequently cited being the collapse of the real estate market. However, according to economists in the state, Arizona, like the nation, has started its economic recovery.

Objectives, Scope, and Methodology

In examining the experiences of the three states, we focused on a broader period—December 1984 through June 1993—than the period when interstate banking laws became effective in those states. We did this because the three states phased in the relaxation of interstate banking laws over time. For example, California began lifting interstate banking restrictions in 1987; Washington in 1983; and Arizona in 1986. Further, two of the states—California and Arizona—have permitted in-state branching for many decades. In addition, many geographic restrictions on banking were removed by states permitting out-of-state banks to expand into the states we examined; many mergers among financial institutions occurred (some involving the largest banks in the western states); and a nationwide recession took place.

In each of the three states, to evaluate the degree of market share among large and smaller banks, we (1) analyzed call report data maintained by FDIC on banks' profitability and market share, along with data on mergers, failures, and new charters maintained by both federal and state

[19]The gross domestic product—the total national output of goods and services, valued at market prices—is a standard measure used to gauge economic growth. The gross state product is the state counterpart. The latest year for which state data are available is 1990.

regulators;[20] (2) reviewed economic research; and (3) met with regulators, bankers, and other interested parties. To assess the availability of credit for small businesses, we examined banks' asset portfolio data, interviewed bankers, and met with focus groups in 11 markets.[21] Our focus groups were composed of individuals who helped businesses apply for bank financing, SBA officials, officials of city and county departments of economic development, and former bankers.

Although the focus group results could not be statistically generalized as representative of small businesses, they offered us a practical means of obtaining a small business perspective on credit availability. Further, since the scope of our work was limited to California, Arizona, and Washington, we could not extrapolate our observations to other states.

FDIC provided written comments on a draft of this report. These comments are presented and evaluated on page 17 and 18 and are reprinted in appendix V. We also requested comments from the Office of the Comptroller of the Currency (OCC) and the Federal Reserve. OCC said it had no substantive comments and the Federal Reserve did not provide comments, which is its policy when we do not make recommendations.

We conducted our work from June 1992 through June 1994 in accordance with generally accepted government auditing standards. We present a more detailed discussion of our scope and methodology in appendix I.

Large Banks' Market Share in the Three States Changed Little

Studies have shown a link between the removal of branching restrictions and banking industry consolidation within a state. On the basis of such studies, many observers predicted that nationwide interstate banking and branching would also lead to consolidation. Such consolidation had not occurred in the three states covered by this report, in part perhaps, because the bank concentration levels for these three states were already high. For example, of the states with a large banking presence,[22] California had the second highest concentration level—with the three largest banks accounting for 62.3 percent of banks' assets. Of the states with a medium

[20]Call reports are quarterly reports of income and condition required by a financial institution's primary supervisory agency.

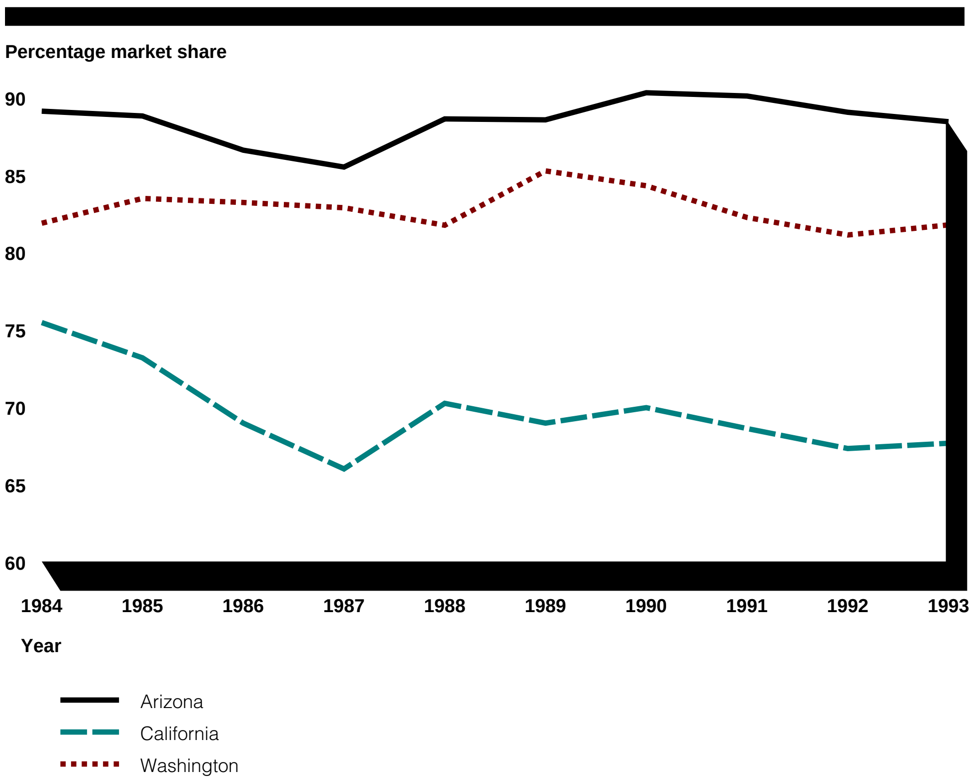
[21]These markets consisted of both urban and rural areas. Urban markets were defined using metropolitan statistical areas (MSA) and rural markets, which were not part of an MSA, were defined using counties. For a description of these markets see appendix I.

[22]We defined these as the 14 states with the largest amount of banking assets of all of the states. California ranked second.

banking presence,[23] Arizona and Washington had the highest and second highest concentration levels, with the three largest banks accounting for 82.6 percent and 62.4 percent of total bank assets, respectively.

Figure 1 shows that the market share the largest banks controlled within each of these states fluctuated over the period we reviewed. However, by mid-1993, these market shares either approximated 1984 levels or fell below those levels.

Figure 1: Market Share of Large Banks for 1984-1993



Note 1: Large banks in California are those with more than $10 billion in assets. Large banks in Washington and Arizona are those with more than $1 billion.

Note 2: 1993 data are as of June 30. All data for the other years are as of December 31.

Source: FDIC call report data.

[23]We defined these as the 12 states with the second largest amount of banking assets of all of the states. Of this grouping, Washington ranked ninth and Arizona, twelfth.

In all three states, some large banks increased their market share, while others saw their share decline or were acquired. Perhaps the most significant event was the 1992 merger of two large bank holding companies, BankAmerica Corporation and Security Pacific Corporation. The merger left BankAmerica with the largest or second largest bank in each of the three states. Table 1 shows the change in the market share of BankAmerica's subsidiaries[24] and their position in each state from 1984 to 1993. The subsidiaries' market share in each state would have been greater, if federal and state regulators had not encouraged BankAmerica to divest some of the branches of its subsidiaries in markets where they felt competition might adversely be affected because of its large presence. For example, without the 1992 divestiture in Washington state, BankAmerica's subsidiary—Seattle-First National Bank—would have had $1.5 billion more in assets than it did as of mid-1993.

Table 1: BankAmerica's Market Share and Ranking for 1984-1993

	1984		1993	
State	Market share	Ranking	Market share	Ranking
California	37.3%	1	41.3%	1
Washington	30.2	1	37.4	1
Arizona	[a]	[a]	28.3	2

Note: 1993 data are as of June 30. All other data are as of December 31.

[a]BankAmerica did not enter Arizona until 1990.

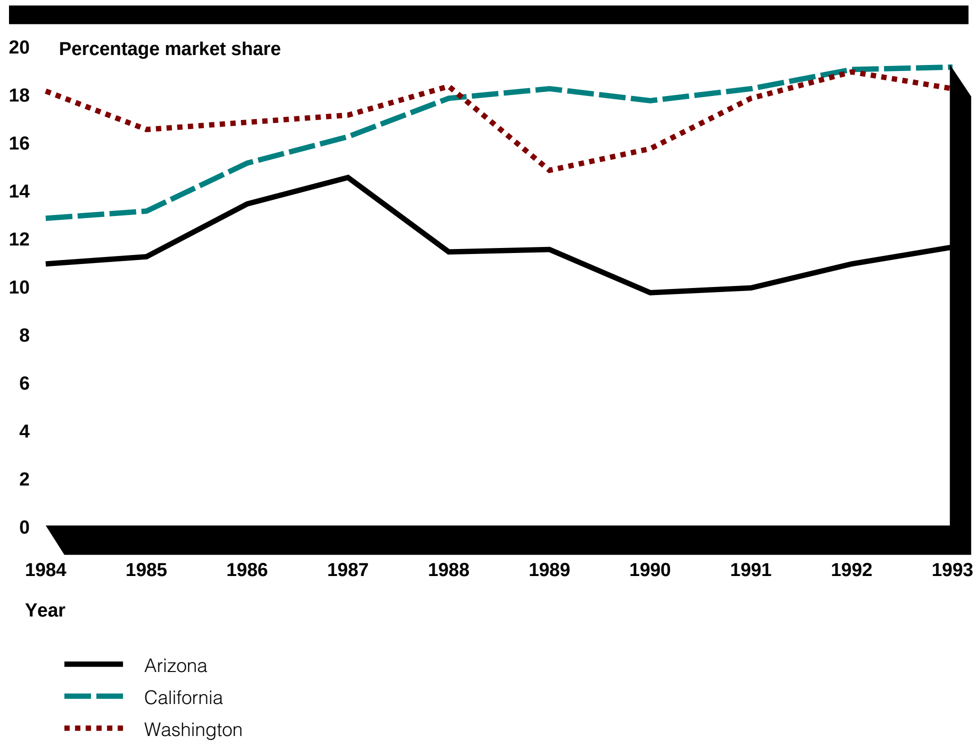
Source: FDIC call report data.

Smaller Banks Remained Viable

Throughout the period we focused on, smaller banks as a group remained viable in the three states. In fact, smaller banks were often among the most profitable banks in California and Washington when measured by return on assets. In Arizona, purchases by out-of-state bank holding companies helped maintain the viability of smaller banks through the infusion of capital. Although smaller banks' share of the market declined temporarily in Washington and Arizona, by June 1993 it had regained or even slightly exceeded its 1984 market share levels. (See fig. 2.)

[24]A subsidiary is a separately chartered and regulated bank that is part of the bank holding company. The California subsidiary is called Bank of America, the Washington subsidiary is called Seattle-First National Bank, and the Arizona subsidiary is called Bank of America Arizona.

Figure 2: Market Share of Smaller Banks for 1984-1993



Note: 1993 data are as of June 30. All other data are as of December 31.

Source: FDIC call report data.

Smaller banks as a group were recapturing market share. However, the smallest banks were losing market share to other small banks with assets from $100 million to $1 billion. Table 2 shows that banks with assets of less than $100 million declined in number and market share in the three states, while those with assets from $100 million to $1 billion increased in number and market share.

Table 2: Changes in Market Share Among Smaller Banks

	Banks with assets less than $100 million				Banks with assets from $100 million to $1 billion			
	1984		1993		1984		1993	
State	Number	Market share	Number	Market share	Number	Market share	Number	Market share
Arizona	37	3.8%	22	2.7%	5	7.1%	10	8.8%
California	346	4.7	250	3.9	89	8.3	176	13.3
Washington	87	9.8	65	6.4	9	8.3	20	11.8

Note: 1993 data are as of June 30: 1984 data are as of December 31.

Source: FDIC call report data.

Regulators, bankers, and many industry experts we spoke with believed that California's long history of in-state branching showed that smaller banks could successfully exist alongside large banks with statewide networks. Smaller banks would always survive, they contended, because such banks carved out special niches that large banks were unable or unwilling to fill.

The number of smaller banks first rose and then fell in California between 1984 and mid-1993, but the market share of smaller banks generally increased throughout this period. Regulators and bankers we spoke with attributed the reduced number more to an economic downturn than to competition from large banks with extensive branch networks. They attributed this decline to economic cycles because smaller banks tend to be more dependent on local economic fluctuations than larger, more diversified banks.

In Washington and Arizona, smaller banks had both out-of-state and in-state ownership. We therefore analyzed trends for these banks both as a single group within each state and by ownership in- or out-of-state.[25] In both states, the market share of smaller banks as a group increased during the first year that these states permitted interstate acquisitions of healthy banks (i.e., 1986 in Arizona and 1987 in Washington). These gains, however, were achieved by out-of-state, not in-state banks.

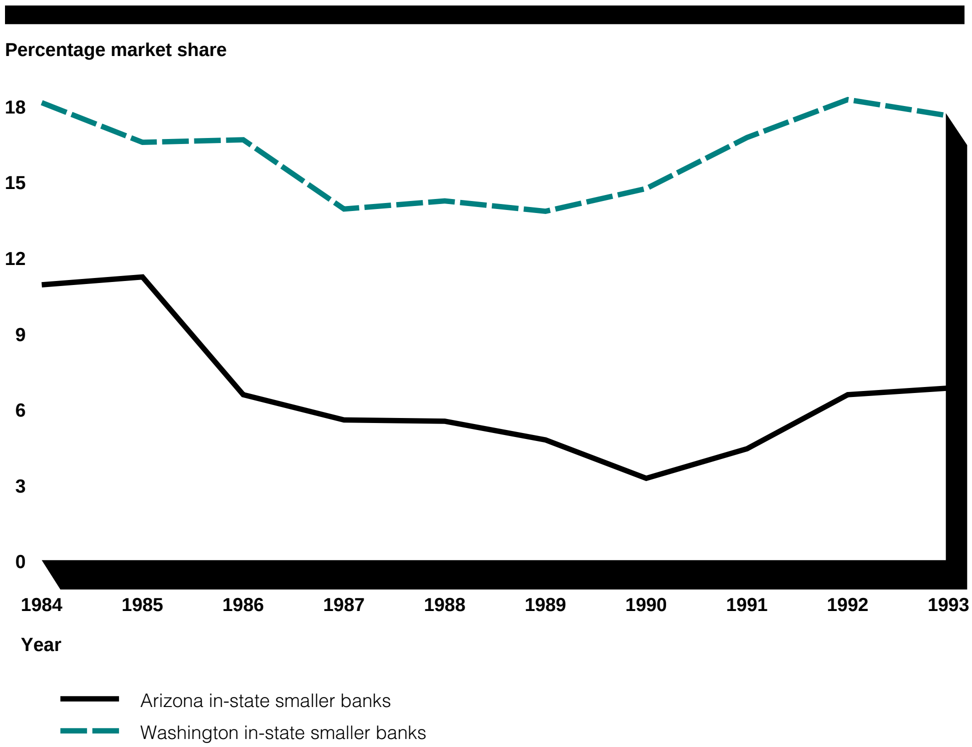
In succeeding years, the market share of smaller banks in both states declined. In Arizona, according to a state regulator, this reduction

[25]California also had a few out-of-state smaller banks. Because of their small presence (0.38 percent of California's banking assets in June 1993), however, they were not analyzed separately from California's in-state smaller banks.

probably occurred because the economic downturn caused many smaller banks to fail. In Washington, we found that the decline was primarily due to one out-of-state bank holding company acquiring several in-state smaller banks and building them into a large bank.

In both states, however, new smaller banks eventually formed. As a result, smaller banks (i.e., in-state and out-of-state banks combined) regained or exceeded the market share they held in 1984, before the states permitted the acquisition of healthy banks within their borders by out-of-state banks. In Washington, the formation of additional in-state smaller banks helped this bank category to regain almost all of the market share it had held in 1984. In Arizona, however, while in-state smaller banks made gains, their 1993 market share declined to about 60 percent of what it was in 1984 (see fig. 3). This decline had more to do with Arizona's "boom and bust" economy than with geographic deregulation, according to regulators and industry experts.

Figure 3: Market Share of Washington and Arizona In-State Smaller Banks for 1984-1993



Note: 1993 data are as of June 30. All data for other years are as of December 31.

Source: FDIC call report data.

In all three states, some markets lacked smaller banks. In each state, we found there were at least three rural counties that lacked smaller banks. Also, focus group participants reported that there were few smaller banks in inner cities in all three states.

Potential Effect on Availability of Credit to Small Businesses

Small businesses are crucial to this country's competitive future. They have traditionally been substantial contributors to both national economic growth and new job creation. In 1989, the most recent year for which data were available at the time of our review, small businesses comprised 93 percent of all businesses in the nation. Opponents of interstate banking are concerned that lifting geographic restrictions will result in greater consolidation of large banks. In their view, such consolidation would harm small businesses because large banks would be less likely than small banks to make small business loans.

Much recent research has focused on credit conditions that affect small businesses. Frequently, such research concluded that small businesses have had more difficulty obtaining credit over the last decade for various reasons.[26] The authors of some of these studies attributed the decline in small business lending primarily to the reduced demand for these types of loans. Others, however, stated that there were a number of reasons for credit difficulties, some of which related to interstate banking, banking industry consolidation, and increased regulatory scrutiny.

Focus group participants and bankers in all three states reported localized difficulties for some types of small businesses seeking loans. Businesses viewed as experiencing credit difficulties included (1) those whose financial statements did not fit standardized criteria, such as nonprofit firms or companies whose profits are cyclical; (2) those borrowing small amounts that do not provide reasonable profits for the bank; (3) businesses that are new or have not had 3 years of profitability; and (4) established companies in “high-risk” industries, such as restaurants (because of high failure rates) or sawmills (because of the poor health of the timber industry). These difficulties, however, were attributed to a number of causes, including a slow economy, tighter regulation, and the lack of a large smaller bank presence in certain areas.

Although nonbanks and other financial providers met some of the needs of small businesses, banks were still viewed by bankers and focus group participants as the major source of credit. Representatives of large banks we interviewed viewed further consolidation resulting from interstate banking and branching as a means to provide credit more efficiently. However, others we interviewed viewed these changes as threatening the interests of small businesses. The most common opinion expressed in focus groups was that although large banks have benefited many small businesses by increasing the volume of small business lending, increased consolidation could cause some small businesses to experience reduced access to credit. Further, focus group participants and many bankers from smaller banks believed that small businesses in certain markets such as rural areas and inner cities may experience problems obtaining credit where there are insufficient credit alternatives to branches of large, interstate banks.

[26]See for example, Quarterly Economic Report for Small Businesses, the National Foundation of Independent Businesses, (Fall 1992); “The Small Business Credit Crunch,” NFIB Foundation, (Dec. 1992); Survey Results of Small and Middle Market Businesses, sponsored by Arthur Andersen’s Enterprise Group and National Small Business United, (July 1992 and June 1993); and “The Credit Crunch: Are Federal Policies Putting Entrepreneurial Firms on a Debt Diet?” (University of Southern California).

We could not ascertain in the three states covered whether large banks would be less likely to provide credit to small businesses because available data were limited. Regulators have data on the commercial lending activity of banks; however, prior to June 1993, these data did not separately identify the amount of lending made to small businesses. Our analysis of June 1993 call report data, the first report with small business lending data separately identified, showed that large banks in California provided the least amount of small business loans in terms of absolute dollars as compared to smaller banks. Further, the amount represented a smaller proportion of their total assets as compared to smaller banks. In Arizona and Washington state, large banks provided the highest amount of small business loans in terms of absolute dollars as compared to smaller banks, but the amount smaller banks provided represented a greater proportion of their total assets.

Several studies[27] have suggested that small businesses may encounter increased difficulties obtaining credit in an unrestricted branching environment because of large banks' loan decisionmaking processes. Large banks generally have processes where lending criteria are standardized and loan decisionmaking is centralized and removed from the local level. Under a centralized and standardized process, local branch managers no longer make loans on the basis of both a financial and a character analysis of the borrower; instead, loan officers working in a central location make loans according to standardized financial criteria. Under such a system, large banks might turn down small business applicants who might otherwise have obtained loans on the basis of other financial considerations, such as conditions unique to a local market or borrower.

Representatives from large banks told us that standardizing loan decisionmaking processes encourages small business lending because it reduces a bank's administrative costs and increases a bank's confidence that loans will be repaid. Focus group participants, however, added that this practice could cause banks to deny loans to businesses that did not meet the standard criteria, because central decisionmakers lacked personal knowledge of the borrowers or markets that might temper their decisions.

[27]"The Impact of Geographic Expansion in Banking: Some Axioms to Grind," Economic Review, Federal Reserve Bank of Chicago, (May 1986); Banking on the States: The Next Generation of Reinvestment Standards, Robert K. Stumberg, Center for Policy Alternatives, (May 1990); "Too Big to Fail, Too Few to Serve? The Potential Risks of Nationwide Banks," Arthur E. Wilmarth, Jr.; "The Proconsumer Argument for Interstate Branching," Federal Reserve Bank of Philadelphia, Business Review, (May-June 1993); and Deregulation and the Structure of Rural Financial Markets, U.S. Department of Agriculture, Rural Development Research Report, number 75.

Focus group participants also identified bank mergers as having the potential to adversely affect small business credit. They believed that small business credit could be affected because the number of banks serving small businesses would be reduced and because the newly merged banks may have a lending philosophy that would not be supportive of small businesses. While some focus group participants viewed some mergers as increasing funds available to small businesses because of a bank's capital and lending philosophy, the more common perception among focus group participants was that mergers involving large banks tended to make credit less available to small businesses within a local area.

Agency Comments

We requested comments on a draft of this report from the Federal Reserve, OCC, and FDIC. FDIC provided written comments, which are reprinted in appendix V, and OCC informed us it had no substantive comments. The Federal Reserve did not provide oral or written comments, as is its policy when we make no recommendations.

FDIC agreed that smaller banks can be profitable and viable, even when faced with much larger competitors. However, it believed that our categorization of smaller banks (i.e., those with less than $1 billion in assets) might be too broad to disclose interesting trends. FDIC provided data dividing this category into those banks with (1) less than $100 million in assets and (2) from $100 million to $1 billion in assets. As FDIC pointed out, a divergent trend was occurring within the smaller bank category (see appendix V). The smallest banks (i.e., those with assets of less than $100 million) declined in number and market share, while those with assets from $100 million to $1 billion increased in number and market share.

Although these trends were divergent, they did not refute our observation that generally the largest banks had not held a greater share of the three states' banking markets than had the smaller banks—a basic concern of opponents of lifting restrictions on interstate banking and branching.

FDIC took issue with our observation that some small businesses may have difficulty obtaining credit. In support of this position, it provided data on the absolute dollar amounts large banks committed to small business lending reported in June 1993 call reports. We agree with FDIC's observation that large banks are a major provider of small business credit. We had also reviewed the same data and made a similar observation in our draft report that large banks have benefited many small businesses. We are not in disagreement with FDIC and have made changes in the report to more clearly reflect this.

FDIC also noted that if problems exist in small business credit access, regulatory efforts and banking laws will address these issues. We agree that laws and regulation can be an important means to help ensure access to credit. However, it is also important to monitor the effects of lifting restrictions on interstate banking and branching to make sure that markets remain competitive and to determine whether changes to laws and regulations are needed. Finally, FDIC recommended that we acknowledge that other factors will also have an impact on the availability of credit. We noted this throughout our report.

We are providing copies of this report to other interested Members of Congress; the Chairman of the Board of Directors, Federal Deposit Insurance Corporation; the Chairman of the Board of Governors of the Federal Reserve System; and the Comptroller of the Currency. We will also make copies available to others upon request.

Major contributors to this report are listed in appendix VI. If you have any questions about this report, please contact me on (202) 512-8678.

Sincerely yours,

Helen H. Hsing

Helen H. Hsing
Associate Director, Financial
Institutions and Markets Issues

Contents

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Abbreviations

C&I	commercial and industrial
CD	certificate of deposit
FDIC	Federal Deposit Insurance Corporation
HHI	Herfindahl-Hirschman Index
MSA	metropolitan statistical area
OCC	Office of the Comptroller of the Currency
ROA	return on assets
SBA	Small Business Administration

Objectives, Scope, and Methodology

Our first report on interstate banking and branching[1] assessed interstate banking's effect on the banking industry nationwide. Our principal objective in this study was to analyze the potential effects of interstate banking and branching on the banking industry by examining three states—California, Washington, and Arizona—where interstate banking and in-state branching existed. Specifically, we focused on how interstate banking and in-state branching affected

- a state's banking structure and the role of large banks;
- the number, market share, and viability of smaller and midsized banks; and
- the availability of credit to small businesses.

Three States Selected

In this report, we used a case study approach to gain a state-level perspective on the effects of laws that allow interstate banking and branching. The case study approach did not allow us to reach definitive conclusions about the possible effects of relaxing interstate banking and branching restrictions nationwide. However, it permitted us to see potential effects on various types of markets.

We chose each state for different reasons. We selected California because it has a long history of in-state branching and a large and diverse economy and population. Thus, by focusing on California, we were able to observe how a relatively consolidated banking industry operated without laws restricting in-state branching and interstate banking. The one limitation of California as a case study was that out-of-state banks have had no significant presence in the state. Therefore, we also chose to study Washington and Arizona, where the majority of banking assets (82.4 percent and 88.3 percent, respectively, as of June 1993) were owned by out-of-state banks. By focusing on Washington and Arizona, we were able to observe the effect that out-of-state ownership of banks had on a relatively healthy economy—Washington—and on a poor economy—Arizona.

Information Sources

To assess the role of large banks and the health of small and midsized banks in each of the three states, we analyzed

[1]GAO/GGD-94-26.

- financial statements, loan portfolio data and deposit information of banks contained in Federal Deposit Insurance Corporation (FDIC) call reports from December 1984 through June 1993; and
- merger, failure, and charter data, from 1984 through 1992, provided by federal and state regulators.

We did not verify the accuracy of these data.

To do our analysis, we used data from banks, rather than that of bank holding companies. Thus, except when we discuss mergers between bank holding companies, we are discussing banks.

To supplement our analysis, we reviewed economic studies by industry analysts. These studies included topics such as geographic diversification, economies of scale and scope, cost savings associated with bank mergers, the relevance of local markets in the analysis of antitrust issues, and the ability of smaller banks to compete with large banks. Finally, in the three states, we held discussions with federal and state banking regulators, staff members of the offices of the attorney general, and bankers. As discussed later in this appendix, we also conducted focus groups with participants who worked with small businesses on financing issues.

Urban and Rural Markets We Visited

To assess the effect of changes in the banking structure on the availability of credit to small businesses, we visited 3 to 4 communities in each state, for a total of 11 markets. We chose these markets, most of which were metropolitan statistical areas (MSA), to obtain both an urban and a rural perspective. [2] We selected markets on the basis of (1) discussions with individuals knowledgeable about small business financing in a state and (2) banking industry data, such as deposit market share and number of banks in a market.

These markets gave us a broad view of small business credit issues by state. They also gave us insights into whether focus group participants and bankers' perceptions of credit problems differed with the size and location of the market.

[2]Most MSAs consist of one or more counties. The general concept of an MSA is that of a "core area" containing a large population nucleus, together with adjacent communities having a high degree of economic and social integration with the core. Some counties, however, are not part of an MSA because they do not meet specified criteria, such as sufficient population or economic and social integration with a core area. These are called nonmetropolitan counties.

California Markets

In California, we focused on four MSAs—Los Angeles, San Francisco, Oakland, and Fresno—and 14 nonmetropolitan counties that we characterized as a single rural market—rural northern California. Los Angeles, the largest MSA in the state, had nearly 9.1 million people in 1992—29 percent of California's population. The area was in the grip of a recession; unemployment surged from 5.8 percent in 1990 to 9.3 percent in mid-1993. According to federal regulators, the banking industry has felt the effects of the recession more in Los Angeles than in other parts of the state. The number of banks in Los Angeles declined from 187 in 1989 to 180 in 1992. (See table I.1.)

Table I.1: Number of Banks for Five California Markets, 1984-1992

Market	1984	1985	1986	1987	1988	1989	1990	1991	1992
Los Angeles	159	167	179	186	186	187	184	185	180
San Francisco	[a]	[a]	[a]	64	75	71	74	72	69
Oakland	[a]	[a]	[a]	53	55	53	54	54	50
Fresno	21	27	29	29	29	28	26	26	26
Rural northern California[b]	57	59	54	56	57	55	58	60	62

[a]Number of banks is not reported for San Francisco and Oakland areas for 1984 through 1986 because they were considered a single MSA during these years; thus, totals for each area were not listed separately. In 1984, the San Francisco/Oakland MSA had 75 banks, and by 1986 this number had increased to 93.

[b]Consists of 14 nonmetropolitan counties.

Source: FDIC data book.

The San Francisco and Oakland MSAs had a combined 1992 population of 3.8 million, or 12 percent of the state's total population. Compared to southern California, this area has a relatively strong economy and low unemployment, but it still was hurt by the recession. From 1990 to 1992, average annual unemployment rose from 3.4 percent to 5.8 percent in San Francisco and from 4.1 percent to 6.5 percent in Oakland. As table I.1 shows, San Francisco lost five banks between 1990 and 1992, and Oakland lost four.

The Fresno MSA, which comprises the entire Fresno county, had a 1992 population of more than 700,000. The area is the nation's number one farming county, with a gross crop value exceeding $2.9 billion. Fresno also serves as the financial, trade, commercial, and educational center for many counties in central California. Like many other parts of the state, Fresno experienced poor economic conditions in the early 1990s; its unemployment rate increased from 10.5 percent in 1990 to 14.5 percent in 1992. When BankAmerica Corporation merged with Security Pacific Corporation in 1992, federal and state regulators were concerned about the possible anticompetitive effects; these concerns were resolved in Fresno when BankAmerica divested $54.2 million of its deposits in the community in 1992. Fresno had 26 banks in 1992.

The 14 nonmetropolitan counties in rural northern California[3] had a 1992 population of more than 500,000. In 1992, the unemployment rates of all these counties increased, and all but one had unemployment rates above the state average of 9.1 percent. During 1992, the number of banks in each county ranged from 0 to 9 and, as table I.1 shows, totaled 62.

Washington Markets

In the state of Washington, we visited four MSAS—Seattle, Spokane, Olympia, and Yakima. Seattle, the largest MSA in Washington, also had the largest number of banks. Its estimated population of more than 2 million in 1992 accounted for 40 percent of the state's population, and its banks numbered 29. (See table I.2.) It is one of the major locations where large banks make lending decisions for other parts of the state. Seattle's principal economic activities include aerospace, high technology, retail and wholesale trade, and manufacturing.

Table I.2: Number of Banks for Four Washington Markets, 1984-1992

Market	1984	1985	1986	1987	1988	1989	1990	1991	1992
Seattle	27	27	28	28	25	28	29	29	29
Spokane	10	10	10	10	10	9	11	12	11
Olympia	8	8	7	7	8	9	8	9	9
Yakima	8	8	8	8	7	8	8	8	8

Source: FDIC data book.

Spokane, which had a population of 375,000 in 1992, is Washington's second largest city. The Spokane MSA had 11 banks in 1992. (See table I.2.) Spokane serves as another major location where large banks make small business lending decisions. The area's principal economic activities include food processing, apparel and textile manufacturing, agriculture, electronics, machinery, and wood products.

[3] We defined rural northern California as all the nonmetropolitan counties north of Sacramento.

Olympia is Washington's state capital. The greater Olympia MSA had an estimated 1992 population of 174,300.[4] Although it is located about 90 minutes south of Seattle by car, it is considered a separate banking market. The Olympia MSA had nine banks in 1992. (See table I.2.) The area's primary industries, other than state government, include wood products, food processing, and agriculture.

The Yakima MSA, which comprises Yakima county in the south-central part of the state, had a 1992 population of nearly 200,000. The town of Yakima is surrounded by small towns and some of its eight banks serve a wide geographic territory. The Yakima MSA is one of the nation's richest agricultural areas, and it also includes food processing and wood processing industries.

Arizona Markets

In Arizona, we visited three MSAs—Phoenix, Tucson, and Yuma. The Phoenix MSA had a population of 2.4 million in 1992,[5] about 62 percent of Arizona's population. This MSA had 31 banks, the largest number in the state. (See table I.3.) Phoenix is one of the major locations where large banks make lending decisions, and it contains the headquarters for the subsidiaries of Arizona's out-of-state banks. Phoenix's well developed, diversified economic base includes manufacturing as its major income producer, electronic production, which it is noted for, and tourism.

Table I.3: Number of Banks for Three Arizona Markets, 1984-1992

Market	1984	1985	1986	1987	1988	1989	1990	1991	1992
Phoenix	31	37	42	44	39	38	33	33	31
Tucson	7	8	8	9	9	8	8	9	9
Yuma	7	7	7	6	7	7	7	8	8

Source: FDIC data book.

Tucson, located about 117 miles southeast of Phoenix by car, had a 1992 population of 700,000. This MSA had nine banks in 1992. Like Phoenix, Tucson is a major location where large banks make loan decisions for Tucson and sometimes for other parts of the state. Tucson's principal economic activities include government and university activities as well as services, tourism, and high-technology manufacturing.

[4]The greater Olympia area includes all surrounding incorporated and unincorporated cities.

[5]As of 1992, the Phoenix MSA includes Maricopa and Pinal counties.

Yuma County, a rural community that became an MSA in 1990, is located in the southwest corner of the state. It had an approximate 1992 population of 112,800. As of 1992, all of the state's large banks and three smaller banks had a presence in Yuma. Some, but not all, loan decisions by large banks are made in Yuma. Yuma's economy is based primarily on agriculture, the military, and tourism.

Focus Group Discussions

In 9 of the 11 markets we visited, we met with focus groups that consisted of 5 to 10 participants who worked with small businesses on financing issues. In two rural markets (Yuma, Arizona and Yakima, Washington), we were unable to identify enough knowledgeable individuals to hold focus group discussions. Therefore, we interviewed the two or three key individuals in each area who, like focus group participants, worked closely with small businesses on financing issues. The results of our focus group discussions include the perspectives of these individuals, which we incorporate in our report.

We interviewed potential focus group participants by telephone and selected those knowledgeable about small business credit issues. These individuals included administrators of nonprofit loan funds, individuals who help businesses obtain bank financing for loans guaranteed by the states or the federal Small Business Administration (SBA), SBA officials, and directors of city and county economic development departments. Most of the focus groups included participants who were former bankers.

We asked each group a number of pretested general questions. These questions explored the participants' perceptions of

- whether small businesses were having problems obtaining credit;
- the nature of these credit problems; and
- the reasons for these problems, including any role played by interstate banking and in-state branching.

We used a focus group format because it was one practical means to obtain a "small business perspective" on banking issues. Focus groups generate a range of perspectives on a specific topic through the use of informal discussions guided by a moderator. The moderator encourages participants to share their views and experiences on specific topics. However, this qualitative methodology is limited in that it cannot (1) statistically estimate the extent of a problem or generalize results to a larger population, (2) provide statistically representative quantitative estimates, or (3) develop a consensus of agreement among parties to any particular problem or solution.

Studies Reviewed and Additional Interviews Undertaken

To compare and contrast the results of our focus groups with other types of research and individual perspectives, we reviewed relevant studies on the availability of credit to small businesses and interviewed lenders from two to four banks in each of the selected markets that were major providers of small business loans. These providers included the largest interstate banks; prominent, smaller banks in all three states; and large in-state banks in Arizona and California. Our interviews focused on

- how the various banks provided small business loans,
- whether some businesses were unable to obtain loans, and
- if so, the reasons why.

Because of a lack of comparable lending data at a local market level, we could not verify the perceptions expressed by focus group participants and bankers about their markets. Nevertheless, the results of our focus groups and the additional interviews provided a perspective that was generally consistent across all the markets we visited. We also reviewed SBA loan data from 1984 through June 1992.

Legislative History Reviewed

We reviewed relevant federal laws and legislation, including the Garn-St Germain Depository Institutions Act of 1982; the Competitive Equality Banking Act of 1987; the Financial Institutions Reform, Recovery and Enforcement Act of 1989; the Federal Deposit Insurance Corporation Improvement Act of 1991; the Bank Holding Company Act of 1956; the McFadden Act of 1927; and the Interstate Banking Efficiency Act of 1994. We also reviewed the California, Washington, and Arizona laws pertaining to interstate banking and in-state branching.

The Banking Structure and Small Business Lending in California

California has permitted statewide branching for state banks since the early part of this century and has had few restrictions on in-state branching by out-of-state banks since 1987. The state's unrestricted in-state branching has contributed to a banking industry that, when compared with many other states and with the country as a whole, is more consolidated, with large banks owning most of the banking assets. Nevertheless, the state has a varied banking structure. In this structure, large, midsized, and smaller banks all play roles in meeting the financial needs of consumers and businesses.[1] The viability of smaller banks in the state has been demonstrated by the increase in their share of the banking market for nearly a decade. This increase has occurred at the expense of large banks with extensive statewide branch networks.

Many factors influence the availability of credit for small businesses, and California's unrestricted in-state branching could be one. However, a direct link between the state's small business credit problems and the state's unrestricted branching structure could not be established. But unrestricted in-state branching does allow banks to become larger, and as banks grow, the relationship between the banker and the borrower may become depersonalized. Some focus group participants said that such a relationship could have made it difficult for some small businesses to obtain loans. Some bankers, however, told us that overall centralization and standardization allow large banks to increase their total amount of small business lending. Difficulties were mainly reported by focus group participants in markets where there may have been few alternatives to large banks. These included (1) inner cities, (2) depressed markets where smaller banks were suffering economically, and (3) rural areas.

California's Economy

In 1990, California ranked as one of the 12 largest economies in the world, with the value of its goods and services estimated to be more than $745 billion (12.35 percent of U.S. goods and services).

In 1989, California's economy completed 7 years of uninterrupted growth. During this 7-year expansion, employment, a key measure of a state's economic health, grew at an average of 3.9 percent per year; it increased by 418,000 jobs to a total of 12.5 million jobs in 1989. However, from May

[1]The bank categories we used in this appendix are (1) large banks with more than $10 billion in assets, (2) midsized banks with between $1 billion and $10 billion in assets, and (3) smaller banks with less than $1 billion in assets. We used current dollars to determine which banks belonged in each of these categories. When comparing the growth trends of banks across several years, however, we used constant dollars to control for inflation.

1990 through February 1994, California lost approximately 850,000 jobs due to the recession.

California has weathered earlier national recessions better than it has the most recent one. In previous downturns, its population growth and favorable mix of fast-growing industries buoyed its economy. Compared with the rest of the nation, during a recession, California never seemed to lose as many jobs and was able to recover much earlier. However, in the most recent recession, California has lagged behind the national recovery. Although by December of 1992, the recession in California had lasted longer and had been more severe than expected, many economists believed that by 1994 California would have resumed its growth. However, since then, economic predictions have become less optimistic because of many factors.

California's Banking History

California has permitted in-state branching for more than 80 years. Initially, however, few banks operated branch networks in the state. In 1905, for example, only five banks had branches.

The first California bank to establish an extensive branch network across the state was the Bank of Italy (now Bank of America). In 1909, it began to buy existing banks, often those in financial trouble, and by 1921, it had 34 branches and resources of more than $1 billion.

California has allowed interstate banking for only a few years. Beginning in July 1987, it allowed banking firms in 12 western states to enter the state provided California banks were granted reciprocal interstate banking privileges in those 12 states. In early 1991, California extended its interstate banking provisions to permit the entry of banking firms from other states that would grant reciprocal privileges to California bank holding companies.

After California passed interstate banking laws in the late 1980s, out-of-state bank holding companies entered the state by buying smaller banks. However, as of June 1993, less than 1 percent of its banking assets were controlled by out-of-state U.S. banks. When U.S. banking assets held by a foreign activity are included in the percentage of out-of-state banking assets, the number increases to almost 15.4 percent.

Several bankers told us that out-of-state bank holding companies have not entered California on a large scale because they lacked the necessary capital to acquire an adequate market share to compete with the large banks already operating statewide. However, several regulators said that large out-of-state banks wanted to expand their presence in California and would find a way to do so.

California Banking Is Relatively Consolidated When Compared to Most Other States

California's long history of in-state branching has contributed to its banking industry being more consolidated than that of most other states. Possibly because of the state's already high level of consolidation, interstate banking has had little effect. One common measure of consolidation is the extent to which banking assets are concentrated among a state's three largest banks. Using this measure, as of December 1992, California ranked 15th in consolidation, with about 62 percent of its banking assets held by its three largest banks. By comparison, as of December 1992, Rhode Island had the highest consolidation level—with its three largest banks controlling nearly 91 percent of its assets; and Oklahoma, the lowest consolidation level—with its three largest banks controlling 21.4 percent of its assets.

Another measure of consolidation is the number of people each bank holding company serves. Using this measure, in 1992, California ranked 10th, with each bank holding company serving 71,000 people. New York ranked as the most consolidated state, with 113,000 people served per bank. The least consolidated state was Nebraska, with 5,000 people served per bank.

Recent Trends Show Decreasing Consolidation

Despite California's standing as a relatively consolidated banking market, recent years have seen it becoming less consolidated as the nation has become more so. The total number of banks in the nation has declined by 3,263 from 1984 through mid-1993, as shown in table II.1. This decline is attributable primarily to mergers (which were facilitated by states allowing both in-state branching and interstate banking) and failures.

Table II.1: Number of Banks Nationwide and in California

	U.S. banks						
	Large		Midsized		Smaller		
Year	Number	Percent	Number	Percent	Number	Percent	Total
1984	24	0.2%	250	1.7%	14,182	98.1%	14,456
1988	40	0.3	319	2.4	13,090	97.3	15,562
1993[a]	53	0.5	316	2.8	11,193	96.7	13,449

California banks						
Large		Midsized		Smaller		
Number	Percent	Number	Percent	Number	Percent	Total
5	1.1%	12	2.7%	428	96.2%	445
5	1.1	14	3.0	452	96.0	471
4	0.9	15	3.4	426	95.7	445

Note 1: Large banks have more than $10 billion in assets; midsized banks have from $1 billion to $10 billion in assets; and smaller banks have less than $1 billion in assets. We used current dollars to determine which banks belonged in which category.

Note 2: Percentages may not add due to rounding.

[a]1993 data are as of June 30. All other data are as of December 31.

Source: FDIC call report data.

In California, there was no net change in the number of banks between 1984 and mid-1993 (see table II.1). Many new banks entered the state during the 1980s, and consolidation followed in the early 1990s. A major reason for the increases in the new entries was the strong California economy that existed during the 1980s, which created a favorable environment in which new banks could form. During this period, California had no in-state branching restrictions and, in 1987, it began to remove interstate restrictions. However, because only a few out-of-state banks acquired or merged with existing California banks, the state's removal of interstate banking restrictions played a minor role in the decrease in the number of banks, but the recession in the early 1990s contributed to a decrease in the number of banks.

The state's history of in-state branching has allowed large banks with extensive branch networks to form. Large banks made up a higher proportion of banks and controlled a greater market share in California than they did nationwide (see tables II.1 and II.2). Conversely, the market share of both midsized and smaller banks is lower in California than it is in the rest of the nation. However, whereas large banks nationwide are increasing in number and in market share, they are losing market share in California. This may not be surprising given the high concentration levels already existing in that state.

Table II.2: Comparison of Market Share Held by Banks Nationwide and in California

	Percentage of market share					
	Banks nationwide			Banks in California		
Year	Large	Midsized	Smaller	Large	Midsized	Smaller
1984	34.6%	28.7%	36.6%	75.4%	11.7%	12.9%
1988	37.3	31.6	31.1	70.2	11.9	17.9
1993[a]	43.4	28.3	28.3	67.6	13.3	19.1

Note: Large banks have more than $10 billion in assets; midsized banks have from $1 billion to $10 billion in assets; and smaller banks have less than $1 billion in assets. We used current dollars to determine which banks belonged in which category.

[a]1993 data are as of June 30. All other years are as of December 31.

Source: FDIC call report data.

Market Share Among Large Banks as a Group Has Decreased

Since 1984, California's midsized and smaller banks have increased their market share, while its large banks as a group have lost market share. As of June 1993, the assets of the large banks in California ranged from approximately $16 billion to nearly $134 billion. These banks comprised three in-state banks (Bank of America, Wells Fargo Bank, and First Interstate Bank California) and one foreign-owned bank (Union Bank). In viewing California as an example of how the country would fare under nationwide interstate banking and branching, we considered its large banks with branches covering the state analogous to interstate banks with extensive branch networks across various states.

The three in-state large banks had more extensive branch networks than the foreign-owned bank, with Bank of America being the largest in-state bank, followed by Wells Fargo Bank. Two of the in-state banks (Bank of America and First Interstate Bank California) also had a substantial presence in other western states, including Washington and Arizona.

To assess the amount of assets and the percentage of market share among the various banks in California, we used 1992 constant dollars. We used constant dollar comparisons to measure increases, or a lack of increases, adjusting for any increase that was caused by inflation. Table II.3 shows that the total assets for large banks decreased by nearly 22 percent between 1984 and mid-1993 and that those for midsized and smaller banks increased by about 1 percent and 30 percent, respectively. During the same period, large banks lost nearly 8 percent of their market share, about two-thirds of which went to smaller banks and one-third of which went to midsized banks.

Table II.3: Comparison of California Banks by Asset Size and Market Share

Constant 1992 dollars in billions

	Asset size			Percentage of market share		
Bank category	**1984**	**1993[a]**	**Percentage of change**	**1984**	**1993[a]**	**Percentage of change**
Large	$286.0	$223.9	- 21.7%	75.4%	67.6%	–7.8%
Midsized	44.3	43.9	- .9	11.7	13.3	1.6
Smaller	48.8	63.2	29.5	12.9	19.1	6.2
Total	**$379.1**	**$331.0**	**6.9%**	**100.0%**	**100.0%**	**0.0%**

[a]1993 data are as of June 30. All other data are as of December 31.

Source: FDIC call report data.

According to our analysis, a large percentage of the loss in assets and market share among the state's large banks occurred from the mid- to late-1980s, after Bank of America and First Interstate Bank California downsized to solve their financial problems.

Mergers of the State's Largest Banks Increased Market Share

As of June 1993, although the market share of large banks was declining overall, the two largest banks—Bank of America and Wells Fargo Bank—had increased their individual shares by merging with other large California banks in 1986 and 1992, respectively. During the recent merger in 1992 between BankAmerica Corporation (the holding company for Bank of America) and Security Pacific Corporation (the holding company for Security Pacific Bank), some consumers and regulators expressed concern about the formation of such a large bank. Both federal and state regulators closely scrutinized the proposed merger because of its size and potential for reducing competition. Although the merger produced a higher concentration level for Bank of America, one state regulator, who was involved in the merger's approval process, told us that the proposed merger was not anticompetitive because it would not have created a monopoly or made price collusion among banks more likely.

Because nationwide interstate banking and branching may encourage mergers among the country's largest banks by removing geographic barriers, an increase in the market share of the largest banks at a national or state level is a real possibility. The Interstate Banking Act addresses this concern by prohibiting interstate mergers if the resulting bank would control more than 10 percent of the total amount of deposits of insured depository institutions in the United States or 30 percent or more of the deposits in any state affected by the interstate merger. States may waive the 30-percent limit. Wells Fargo Bank, the surviving bank from the 1986 merger between Wells Fargo & Company and Crocker National Corporation (the holding company for another large bank), retained the market share increases from this merger. In the case of the 1992 merger between BankAmerica Corporation and Security Pacific Corporation, it is too soon to tell whether or not the surviving bank, Bank of America, will retain its market share increases in the future.[2]

Table II.4 shows the asset sizes and market share of the state's three largest banks in 1984, 1986, 1989, and June 1993. In 1984, Bank of America reached its peak asset size. Then from 1986 through 1989, its size and market share decreased in part due to its financial problems. This downsizing reduced the gap between Bank of America and Security Pacific Bank, the state's second largest bank during that period. Bank of America declined from approximately 2.6 times to 1.6 times the size of Security Pacific Bank.

Table II.4: Changes Among California's Three Largest Banks Between 1984 and June 1993

Constant 1992 dollars in billions

	Bank of America		Security Pacific Bank		Wells Fargo Bank	
Year	Asset size	Percentage of market share	Asset size	Percentage of market share	Asset size	Percentage of market share
1984	$141.5	37.3%	$54.6	14.4%	$32.7	8.6%
1986	118.0	31.4	61.3	16.3	50.6	13.5
1989	98.8	26.8	61.9	16.8	51.9	14.1
1993[a]	136.6	41.3	[b]	[b]	50.9	15.4

[a]1993 data are as of June 30. All other data are as of December 31.

[b]Security Pacific Bank data were not available for 1993 because it had merged with Bank of America.

Source: FDIC call report data.

In 1986, when Bank of America was beginning to downsize, Wells Fargo & Company (the holding company for the state's third largest bank) bought Crocker National Corporation (the holding company for California's largest foreign-owned bank at that time). This merger increased Wells Fargo Bank's assets from $32.7 billion to $50.9 billion and brought its asset

[2]Mergers can result in a loss of market share. For example, some customers may choose to leave the newly formed larger bank for a variety of reasons. Bankers from smaller banks told us that this "run-off" often results in their customer base increasing, thus, they do not feel threatened by mergers within their communities.

size closer to that of Security Pacific Bank's $61.9 billion.[3] The merger also increased the market share of Wells Fargo Bank by more than one-third (from 8.6 percent to 13.5 percent), and this greater presence made it more able to compete against other large banks in the state.

The Wells-Crocker merger also resulted in the demise of Crocker National Bank, a large bank. Within a few years, however, a midsized bank grew into a large bank, returning the number of large banks in the state to five. In 1988, Bank of Tokyo, the owner of a midsized foreign-owned bank operating in California under the name Union Bank, merged with another foreign-owned bank about two-thirds of its size. This merger increased Union Bank's assets to more than $18 billion in current dollars.[4] Its market share also increased from 3.2 percent to about 5 percent and has changed little through June 1993.

In 1992, the second large merger in California occurred. In this merger, BankAmerica Corporation merged with Security Pacific Corporation. This merger led to the elimination of the state's second largest bank, Security Pacific Bank, and increased the size of the state's largest bank, Bank of America. By June 1993, Bank of America's assets increased by nearly $33 billion to $136.6 billion, and its market share increased by more than 13 percent to 41.3 percent. The second largest bank in 1993 was Wells Fargo Bank, which was less than half the size of Bank of America. As of mid-1993, Wells Fargo Bank had $50.9 billion in assets and a market share of 15.4 percent.

A comparison of the two largest banks in 1984 and June 1993 (in constant 1992 dollars) can provide insight into how the merger between BankAmerica Corporation and Security Pacific Corporation changed the structure of the large bank market in California. Table II.4 shows that in 1984, before it began downsizing, Bank of America was nearly $5 billion larger than it was in 1993, after the merger. Moreover, the merger did not significantly increase Bank of America's size relative to the number two bank (Security Pacific Bank in 1984 and Wells Fargo Bank in 1993). It was about 2.6 times as large as the second largest bank in 1984 and 2.7 times as large in 1993.

[3]Unless stated otherwise, asset sizes are in constant 1992 dollars. The current dollar figures for these banks are: Wells Fargo at $23.5 billion in assets before the merger and $39.2 billion after the merger; and Security Pacific at $47.5 billion.

[4]In constant 1992 dollars, Union Bank would have been classified as a large bank at least since 1984 because its assets were more than $10 billion.

The merger structurally affected Bank of America's market share, however. For the period we focused on before the merger, Bank of America's largest portion of the market was 37.3 percent in 1984; whereas in 1993, after the merger, its share was 41.3 percent (see table II.4). In comparison, from December 1984 through June 1993, the market share of the second largest bank increased 1 percentage point, from 14.4 percent to 15.4 percent. Moreover, the gap in market share between Bank of America and the second largest bank widened as a result of the merger. In 1984, Bank of America's market share exceeded that of the second largest bank—Security Pacific—by 23 percentage points, and in June 1993, when Wells Fargo Bank was the second largest bank, this margin increased to about 26 percentage points.

Although federal and state regulators did not believe that Bank of America's post-merger size posed a threat to competition in most markets in California, they recommended that it divest a number of branches it had in certain markets that the regulators viewed as being susceptible to anticompetitive effects. During the merger approval process, the regulators conducted an analysis within local markets to determine whether the merger would cause an impact on competition. In markets where they felt the merger was potentially anticompetitive, they obtained BankAmerica Corporation's agreement to divest a portion of its branches to another competitor. In total, BankAmerica Corporation divested 53 of its branches to Union Bank and U.S. Bank.

The local market analysis conducted by the regulators also included the regulators' calculation of the Herfindahl-Hirschman Index (HHI). HHI measures concentration of market share by adding together the squares of the percentages of total deposits each bank or thrift holds in a local market. This calculation accounts for both the number of banks and thrifts in a market and their relative sizes—since squaring the market shares emphasizes the larger organizations. The maximum value of the HHI is 10,000 (100 percent squared) for a market with only 1 bank or thrift, while the minimum approaches 0 for a market with a very large number of similarly sized banks and thrifts.

In general, regulators will further investigate the effect of any merger that could add 200 or more points to a local HHI of 1,800 or higher.[5] An HHI of 1,800 corresponds to a market in which the top 3 or 4 banking companies account for about 70 percent of the market share.

[5]For more information on the merger approval process, see GAO/GGD-94-26.

Of the 30 markets where BankAmerica divested branches, 14 were above the 1,800 cutoff before the merger and were projected to have no change in their HHIs with the divestiture. In the remaining 16 markets that were below the 1,800 cutoff, 3 experienced no change in the HHI after the divestiture, and 13 had a change of between 20 and 676 points.

Smaller Banks Were Viable Under Unrestricted In-State Branching

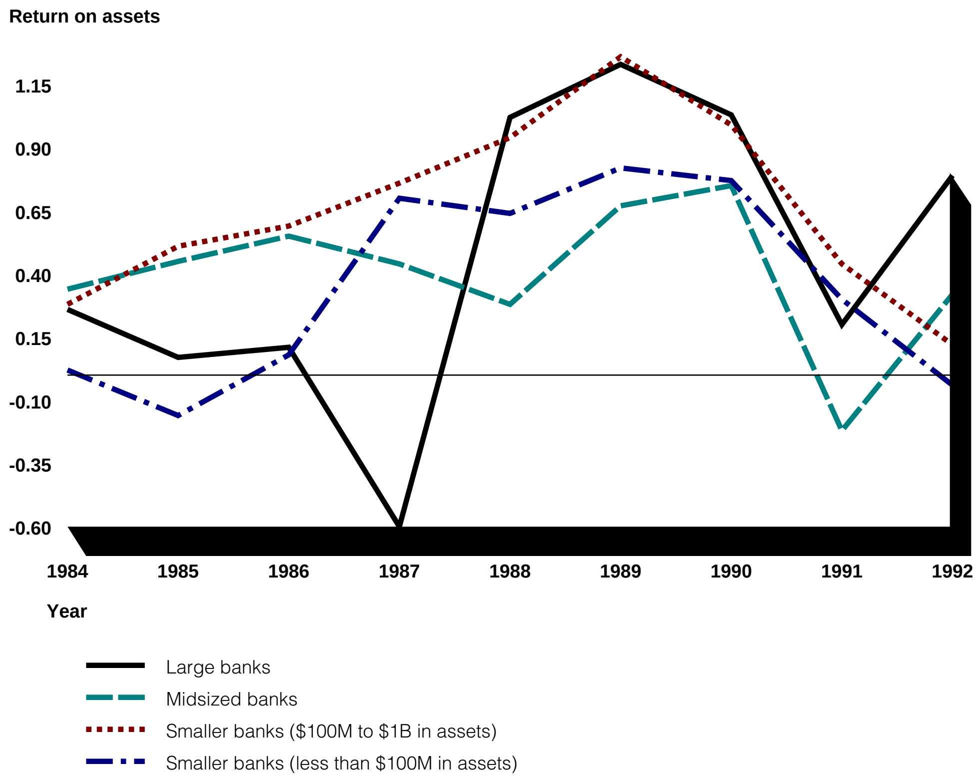
Because smaller banks have existed alongside large banks with extensive branch networks for decades in the state, California provided us with some particularly useful insights into the question of the survival of smaller banks. The smaller banks distinguished themselves from their larger counterparts by carving out specialized niches, such as agricultural or SBA lending and offering personalized service. For this reason, regulators, bankers, and many industry experts told us that although individual smaller banks may have come and gone, their survival as a group was ensured.

Smaller banks generally operated in one or two markets and were commonly found in both urban and rural areas. Smaller banks tended to make fewer loans as a percentage of assets than either large or midsized banks, and their loan portfolios tended to be more oriented toward commercial rather than consumer loans.

Market share data, profitability indicators, and perceptions of regulators, bankers, and industry experts, all led us to the conclusion that smaller banks were a profitable and viable part of California's banking industry. Smaller banks have successfully competed in an environment where large banks control more than 50 percent of the banking assets and operate without substantial branching restrictions.

The profitability of smaller banks varied with size. Those with assets of $100 million to $1 billion earned the most consistently high return on assets (ROA) of any bank category from 1984 through 1992. However, those with less than $100 million generally earned among the lowest ROAs over this period. (See fig. II.1.)

Figure II.1: ROA by Asset Size for California Banks



Note: Large banks experienced a significant decline in ROA in 1987 because Bank of America, Security Pacific, and First Interstate all had negative ROAs that year.

Source: FDIC call report data.

Forty-five regulators, bankers, and industry experts we spoke with in California provided us with further indications of the viability of smaller banks. They contended that smaller banks were a viable part of the banking industry in California, effectively competing against both midsized and large banks with extensive branch networks. Many of them also noted that the success of smaller banks in an unrestricted in-state branching state, such as California, suggested that smaller banks would continue to be a viable component of the banking industry nationwide under interstate banking and branching.

Most of the 17 bankers from smaller banks we spoke with in California believed that large banks, regardless of whether they were in- or out-of-state banks, did not threaten their survival. For example, two bankers mentioned that a large bank's acquisition of a bank in their community would be an opportunity to increase their own market share. They would expect some of the customers at the "target bank" to switch to a different bank because of unfamiliarity with the acquiring bank. Also, according to several federal regulators, if a large, nonlocal bank buys the only remaining smaller bank in an area, within a few years a new local smaller bank is often formed.

The number of smaller banks fluctuated greatly within California between December 1984 and June 1993. Regulators and bankers attributed such changes to economic cycles, not to competition from large banks with extensive branch networks. According to regulators, smaller banks that were dependent on a local economy were more likely to experience problems during economic downturns than larger, more geographically diversified banks. Full nationwide interstate banking was often cited as beneficial, in part, because it can facilitate such diversification. However, regulators cautioned us that geographic diversification in and of itself does not ensure that banks will never get into financial trouble. They believed that the management philosophy of a bank was more of a primary determinant of safety and soundness.

The number of smaller banks increased from 428 in 1984 to a peak of 460 in 1990. New bank entry into California was especially prolific in the mid-1980s, coinciding with the state's strong economic growth. Fewer mergers occurred in 1985 and 1986 than in most other years through 1992, and most of the consolidation that did occur consisted of smaller banks that were purchased by other smaller banks. Beginning in 1987, however, the rate of consolidation started to increase as banks with assets of more than $1 billion became more active acquirers. During the 1991 and 1992 recession, the number of smaller banks declined by 22, as consolidation more than offset new bank entry. By mid-1993, there were 426 smaller banks, two less than in 1984.

The total market share of smaller banks steadily increased from 12.9 percent in 1984 to 19.1 percent in 1993, despite the recent decrease in their numbers. This approximate 6-percent increase was generally taken from large banks, which lost about 8 percent of their market share during this period.

While smaller banks as a group were recapturing market share, a divergent trend was occurring within the group. That is, the market share held by banks with assets of less than $100 million declined from 4.7 percent to 3.9 percent, while the market share for banks with assets from $100 million to $1 billion increased from 8.2 percent to 13.3 percent.

Midsized Banks Were Viable Under Unrestricted In-State Branching

Another bank category that regulators identified as being at risk under nationwide interstate banking and branching was the midsized bank. According to regulators, such banks were often seen as attractive targets for acquisition by interstate banks. However, the potential of such banks for acquisition does not mean that they will cease to exist as a group.

Midsized banks had expanded in California over the period we focused on, both in number and market share. This expansion showed that they were a viable part of the California banking industry. They were not only successfully competing but were gaining market share largely from the type of banks that opponents of interstate banking and branching feared could come to excessively dominate the industry—large banks with extensive branch networks covering a wide geographic area.

In California, midsized banks had from $1 billion to $10 billion in assets and consisted of both foreign- and domestic-owned banks. As of June 1993, there were 15 such banks in the state. These banks tended to operate in the state's MSAS, particularly its two largest MSAS—the Los Angeles Basin and the San Francisco Bay Area. In general, their lending is more commercial than consumer oriented.

Foreign-owned banks, many of which are Japanese-owned, were a major component of the midsized bank category in California. During the period 1984 through 1993, foreign-owned midsized banks accounted for a high of about two-thirds and a low of about one-third of the banks in this category. These banks tended to be located in midsized and large urban areas, where there were significant concentrations of business customers. Foreign-owned banks tended to make more loans than did the domestic midsized banks overall and they emphasized commercial lending over consumer lending more so than did the domestic banks.

As a group, midsized banks often earned the lowest ROAS of any bank category between 1984 and 1992. (See fig. II.1.) ROAS ranged from .22 percent to .75 percent. Foreign-owned banks accounted for a significant portion of the comparatively low ROAS in this category. The

ROAs of domestic midsized banks were either the highest or among the highest when compared to other bank sizes in most years between 1984 and 1992.

Midsized banks were thought to be likely targets for future out-of-state acquisitions, both in California and nationwide. For example, California regulators believed that large out-of-state banks would most likely expand their presence in California by purchasing midsized banks, because such banks operate in urban markets that are attractive to these potential acquirers.

The attractiveness of midsized banks to out-of-state acquirers does not mean, however, that these banks will no longer exist as a group. In California, although some midsized banks have been purchased by larger banks, others have been bought by other midsized banks, and remain within this bank category. Still others have survived intact.

Between 1984 and 1987, the number of midsized banks in California increased from 12 to 19, then declined to 15 as of June 1993. The market share of such banks followed a similar pattern, increasing from 11.7 percent in 1984 to nearly 18 percent in 1987 and decreasing to 13.3 percent by mid-1993. The 1.6 percent net increase in market share from 1984 to 1993 was gained from the large banks, which was the only bank category experiencing a net decline during this time.

Research Has Been Unable to Explain the Pricing of California Banking Services

The pricing of banking services is another area of concern. In California, consumer groups and the media have suggested that they believed California banks offered lower interest rates on deposits than banks in other parts of the country. A 1990 study conducted by the Federal Reserve Bank of San Francisco explored whether these pricing differences existed and, if so, the reasons for them.[6] The authors of the study looked at transaction accounts[7] and certificates of deposits (CD) and found that California banks clearly offered lower interest rates than the rest of the country on transaction accounts but not necessarily on CDs.[8]

[6]Bank Pricing of Retail Deposit Accounts and "The California Rate Mystery," Jonathan A. Neuberger and Gary C. Zimmerman, Federal Reserve Bank of San Francisco, (Spring 1990).

[7]Transaction accounts consisted of negotiable order of withdrawal accounts and money market deposit accounts.

[8]The study examined interest rates paid on the various accounts from 1984 to 1987, using a sample of 435 banks nationwide and 29 California banks.

The authors could not determine why California pricing differed from that of the rest of the country. However, they did find that some differences were partially explained because (1) the characteristics of bank markets in California differed from those in the rest of the country and (2) California banks responded to the determinants of deposit rates differently than their counterparts did elsewhere.

The authors then speculated that interstate banking and branching may have contributed to California banks tending to set interest rates differently from their counterparts elsewhere. That is, entry by only a few out-of-state banks in California may have shielded California banks from influences outside the state's borders. If more non-California banks enter the state in the future, a key question may be whether these banks will continue to set deposit interest rates as they did outside the state or whether they will respond like their California counterparts in setting these rates.

Small Business Lending Experience in California Under Unrestricted In-State Branching

Bankers and small business representatives told us that some small businesses in certain types of markets in California were having difficulty obtaining loans. However, we were unable to determine if this difficulty was the direct result of unrestricted in-state branching because many factors (e.g., poor economic conditions and regulation) were seen by bankers, focus group participants, and industry experts as contributing to credit availability problems.

Focus group participants and some bankers told us that the practices of centralizing and standardizing loan decisions, common to large banks, could result in some small businesses having difficulty obtaining credit in markets where there were few alternatives to large banks. These businesses could have difficulty because the relationship between the banker and the borrower becomes depersonalized under such lending practices, which would make it difficult to fund would-be borrowers who may be creditworthy but not "gold plated." However, other bankers told us that although it may be true that some small businesses may find credit more difficult to obtain, overall, centralization and standardization allow large banks to increase their total amount of small business lending.

Data on Small Business Lending Is Incomplete

One step in the determination of whether unrestricted in-state branching affects small business lending is to ascertain (1) which type of banks—large banks with extensive branch networks or smaller banks—are the more common providers of small business loans and (2) the extent of their business lending. Although data was limited on this subject, two sources—quarterly statements banks submit to regulators, known as call reports, and SBA loans—showed that all types of banks were key providers of commercial loans.

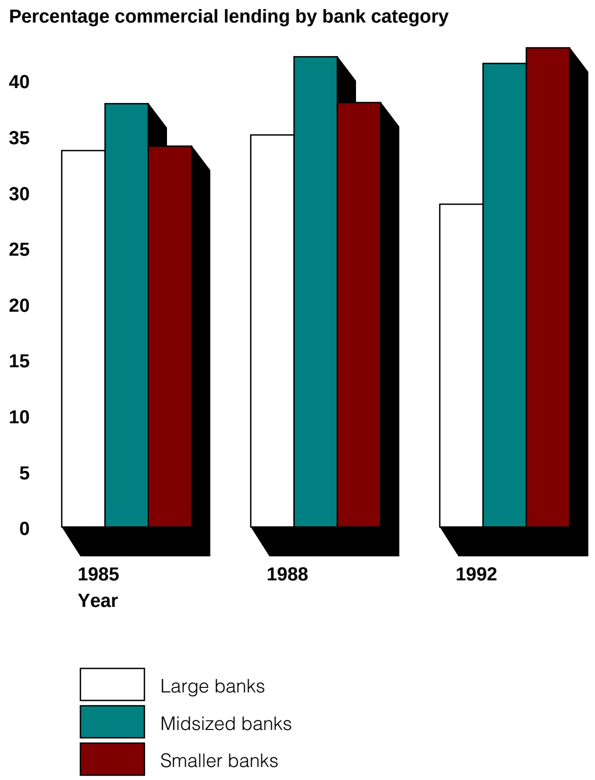
Although call reports are a major source of lending data, they are limited because (1) until June 1993, they reported only the total amount of commercial lending done by different sizes of banks and thus did not list separately the amount of small business lending and (2) some small businesses may obtain financing through home equity, credit card, or other types of loans not classified as commercial lending. Nevertheless, call report data provided us with an insight into the type and amount of commercial lending generally undertaken by banks.

Our analysis of these data indicated that from 1985 through 1992 midsized and smaller banks devoted a higher proportion of their assets to commercial lending. Figure II.2 shows the commercial loan-to-asset ratio by year. Depending on the year, midsized banks had a commercial loan-to-asset ratio that ranged from 38 to 42 percent, smaller banks had a ratio that ranged from 34 to 43 percent, and large banks' ratio ranged from 29 to 35 percent.[9] Also during this period, smaller and midsized banks increased their total amount of commercial lending, whereas large banks decreased theirs. Commercial lending included both commercial and industrial (C&I) loans and commercial real estate loans.[10]

[9]In absolute dollars, large banks made the most commercial loans. In 1992, for example, total commercial loans from (1) large banks were $65.9 billion, (2) midsized banks were $19.4 billion, and (3) smaller banks were $27.2 billion.

[10]Commercial real estate loans included all commercial loans, regardless of purpose, that were secured by real estate. C&I loans included all commercial loans that were secured by something other than real estate or were unsecured. Thus, if a bank made a loan to a firm that was secured by real estate it would be a commercial real estate loan. However, if that same loan was secured with something other than real estate collateral, it would be a C&I loan.

Figure II.2: Percentage of Assets in Commercial Lending in California

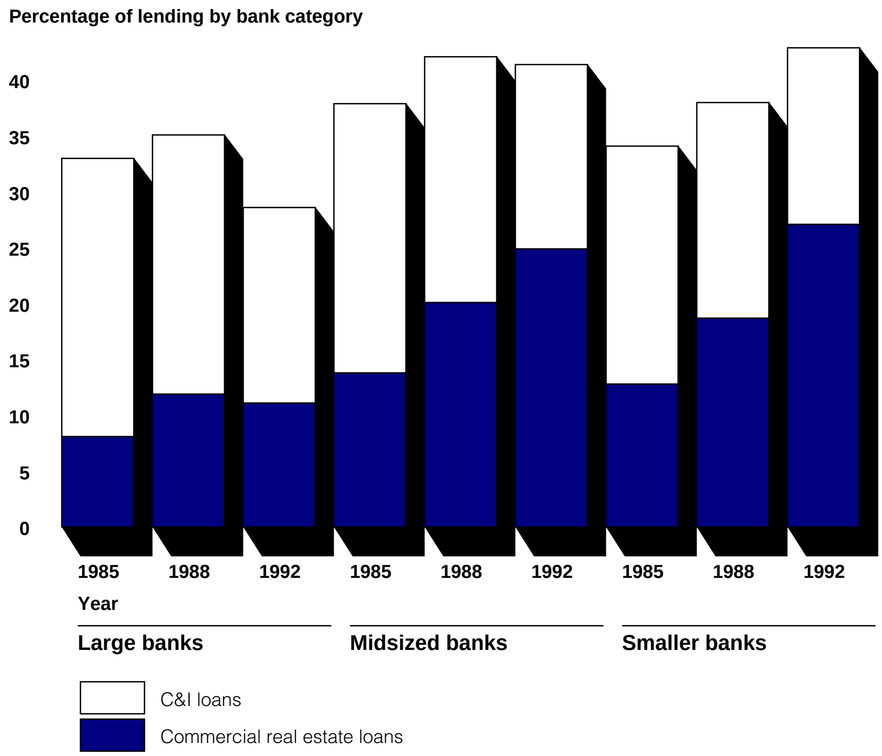


Note: Commercial lending included both C&I loans and commercial real estate loans.

Source: FDIC call report data.

Types of commercial lending also differed among the three bank categories. Figure II.3 shows that midsized and smaller banks generally provided more commercial real estate loans than C&I loans, whereas large banks did the opposite. It also shows that although all three bank categories increased their real estate lending over the period, smaller banks and midsized banks had the greatest increases. In addition, as real estate lending increased for each bank category, C&I lending decreased.

Figure II.3: Commercial Lending in California



Source: FDIC call report data.

June 1993 FDIC call report data contained, for the first time, the number and amount of outstanding small business loans. Small business lending encompassed all commercial real estate and C&I loans of less than $1 million. However, because June 1993 was the first time that these data had been collected, regulators cautioned that the potential for reporting errors was greater than usual because banks could possibly misinterpret the instructions or have uncertainties about the classification of specific information, or because of other factors.

Our analysis of June 1993 call report data showed that of the three bank categories, smaller banks devoted a higher percentage of their assets to small business commercial lending. The data also showed that smaller banks provided the most credit to small businesses. For the 3 months ending June 1993, smaller banks made commercial loans (i.e., C&I and commercial real estate) that totaled nearly $13 million, or 20.9 percent of their assets. This amount was more than twice the dollar amount provided by large banks and more than three times the amount provided by midsized banks. Midsized banks provided the least amount of credit at $4 million. Although midsized banks committed less money to small businesses, they provided a greater percentage of their assets, 9.3 percent, as compared to large banks' 2.9 percent. We also found that these trends did not change when C&I loans and commercial real estate loans were analyzed separately.

In doing our review of SBA lending in California, we learned more about the type of small business lending done by different sized banks. We also obtained some insights into the role nonbanks[11] play in providing this type of credit. Our review showed that SBA guaranteed loans are made primarily by smaller banks and nonbanks.

SBA loans are long-term loans, generally made for 6 or more years with SBA guaranteeing up to 90 percent of the loan amount. In a 1983 report, we estimated that 30 to 40 percent of all long-term small business loans were guaranteed by SBA.[12] Although this report is several years old, it is the most current estimate of the magnitude of SBA loans to the small business community.

Table II.5 shows smaller banks making the majority of SBA loans, followed by nonbanks. Large and midsized banks provided relatively few SBA loans.

Table II.5: SBA Lending in California by Type of Institution for 1988-1992

Type of institution	Number of loans	Percentage of total lending
Smaller banks	9,818	68.5%
Nonbanks	3,207	22.4
Large banks	496	3.5
Thrifts and saving banks	476	3.3
Midsized banks	330	2.3

Source: SBA data.

[11]Nonbanks include private companies specializing in SBA loans, such as The Money Store, bid companies, nonprofit and public certified development corporations, and loan funds.

[12]SBA's 7(a) Loan Guarantee Program: An Assessment of Its Role in the Financial Market (GAO/RCED-83-96, Apr. 25, 1983).

According to an SBA official, large banks used to be strong providers of SBA loans but largely dropped out of this market in the early 1980s. The proportion of SBA loans made by Bank of America, Security Pacific Bank, First Interstate Bank California, Wells Fargo Bank, and Union Bank declined from 20.1 percent in 1984 to 3.7 percent in 1992. However, this same official commented that large banks have recently begun to express interest in becoming more active SBA lenders.

Other Sources of Small Business Lending

In the markets we visited in California, nonbanks, as shown in table II.5, were a source of loans for small businesses. Nonbanks included nondeposit institutions, finance companies, and nonprofit and public loan funds. These loan funds, which are managed by city or county agencies, typically provided loans to small businesses for which credit was not otherwise available. However, because the amount of their funding was limited, these funds could not meet all demands.

Trend Toward Centralized and Standardized Loan Decisions

Large banks in California were seen as important sources of small business financing by bankers and focus group participants. However, the way each of these banks goes about lending was changing toward a more centralized and standardized process. These changes resulted from the banks' attempts to improve efficiency and performance, instead of as a direct consequence of in-state branching, interstate banking, and consolidation.

Officials at several large banks said that their banks did not aggressively target small business loans in the 1980s because they did not find such loans profitable. According to the officials, although the loans were made in the branches by branch managers, strategies were not developed to make this lending cost-effective. For example, making a small loan was as costly as making a large loan; therefore, to earn a higher return, bankers preferred to focus on making larger loans.

However, the four largest banks have changed their small business lending strategy. Senior officials from these banks viewed small businesses as belonging to a sector with opportunities for profit. These officials told us that large banks were now aggressively going after small business loans. Through centralized and standardized decisionmaking processes, they believed that they could make these types of loans profitably. Under such decisionmaking, small business loans were no longer made by branches at the three largest banks but by loan officers in central processing centers.

The fourth bank's loan officers, while in the branch, reported to regional senior loan officers. Because an objective process was needed to monitor a large volume of loans, centralization led to standardized underwriting criteria.

Centralization May Affect Credit Availability

Because available data do not fully address credit availability issues for small businesses, we selected four markets to review for more insight into these issues.[13] We interviewed regulators, industry experts, and bankers from large and small banks and held focus group discussions with individuals who worked with small businesses on financing issues. In discussions with our California focus groups, we found a possible indirect effect of in-state branching on small business credit availability. This effect was that small businesses had difficulties in obtaining certain types of loans because of the increased centralization and standardization of lending decisions. These difficulties consisted of some small businesses either not being able to obtain credit or eventually obtaining it only after approaching several banks. This lengthy search for a lender was reportedly costly and resulted in missed opportunities.

The most prevalent view among bankers from smaller banks we interviewed and focus group participants was that centralized and standardized decisionmaking was one of several factors that impaired credit availability for some types of small businesses. Many focus group participants and bankers told us that central decisionmakers of large banks lacked local knowledge, provided little personalized assistance, and were less likely to consider special circumstances. Focus group participants and bankers from smaller banks attributed credit difficulties to economic and regulatory factors, as well as to the lending practices of large banks.

Although bankers from large banks believed that centralized and standardized decisionmaking had the potential to provide more business loans, most also recognized that loans to certain applicants could be denied. According to one banker from a bank that used a standardized process known as credit scoring, a loan that was declined was not necessarily a bad loan. However, if 10 loans like it were to be made, the bank would run the risk that one of these 10 would fail, which would eliminate all profits from the other 9 loans. Because the scoring model could not predict which of the 10 borrowers would be the one most likely

[13]The markets we selected were San Francisco; Los Angeles; Fresno; and rural northern California, which consisted of 14 northern rural counties. See appendix I for a brief description of each market.

to default, the bank must decline all the loan applications in this category. Although the scoring system might protect the bank from defaults and increase the bank's total amount of small business lending, it could result in the bank rejecting loan applications that could have been repaid by the would-be borrowers.

Focus group participants and some bankers described the types of small businesses likely to have problems obtaining loans as those businesses

- whose financial statements were unusual, such as nonprofit firms or companies whose profits were cyclical;
- needing small loans, such as loans for less than $100,000, or unsecured lines of working capital;
- that were new or did not have 3 years of profitability; and
- that were well-run, established companies in "high-risk" industries, which in California included real estate and timber.

Most bankers at large banks told us that centralized decisionmaking encourages small business lending. For example, one large California bank installed a system whereby loans of less than $250,000 were referred to a central "community banking group." Loan officers in this group had expertise in credit analysis for specific industries as well as an incentive to make small business loans. The bank relied on input from the branch manager for familiarity with the borrower. Bank officials believed that this system allowed the bank to meet the banking needs better than it could when branch managers were making the decisions because these managers lacked the necessary expertise and, as we previously mentioned, small loans made on a case-by-case basis were often not profitable for larger banks.

This bank appears to be an example of an observation made by some of our focus group participants: that the degree of small business lending depends more on a bank's lending philosophy than on its size or processes. For example, participants told us that when an out-of-state bank bought a thrift in northern California, it began providing greatly needed small business loans. Another participant, who operated the state's equivalent to the SBA loan guaranty program, cited a smaller bank that had been a strong agricultural and small business lender. When that bank was acquired by a large bank, this participant said that it stopped providing many agricultural-related loans, which hurt small business.

Credit Availability Problems Reported in Certain Types of Markets

Centralization and standardization and industry consolidation were seen by focus group participants as a problem in markets where they perceived that there were not sufficient alternatives to large banks. Types of markets specifically mentioned by participants were inner cities; depressed markets, where smaller banks were experiencing an economic downturn; and rural areas.

Several focus group participants expressed concern that certain large banks, with loan centers located in other areas, do not make certain loans because the decisionmakers are unfamiliar with the inner city markets. The participants believed that inner cities are particularly susceptible to this problem because of a built-in predisposition for banks to view these communities as “high risk” areas, regardless of the creditworthiness of the businesses located within them.

One participant related the following example. An owner of three small food markets in Los Angeles, who had been in business for 25 years and had excellent collateral, needed an $800,000 loan to renovate one of his stores in a poor section of the city. Working with the Los Angeles Department of Community Development, the owner approached the community reinvestment officers of five large and midsized banks, all of whom felt that it was a good loan. According to the focus group participant who worked with the owner to obtain financing, the commercial lending groups of each bank, however, turned down the loan because they viewed the community in which the store was located as a risky area. After turning it down twice, a large bank finally agreed to fund $500,000 of the request because the city’s development department agreed to fund the rest of the loan, or $300,000.

The focus group participant relating this story believed that communities such as this one suffered because they contained few locally based banks. He contended that local banks were more likely than those who made lending decisions outside of the community to look beyond a neighborhood’s problems or “riskiness” and place more emphasis on whether the loans were good and the value that such loans might bring to the community.

Similar difficulties were seen for small businesses in depressed markets, where smaller banks were experiencing an economic downturn. Some focus group participants and bankers we spoke with mentioned that smaller banks had cut back on their small business lending as a result of this downturn.

The final areas about which credit access problems were frequently mentioned by focus group participants and some bankers were rural areas. These localities typically had fewer banks, regardless of branching laws. Mergers and new entries were also comparatively rare. In California, as of year-end 1992, 5 of 27 rural counties lacked smaller banks, and in another one, smaller banks had less than a 5-percent share of the market.

A Department of Agriculture study noted that under interstate banking and in-state branching, while the number of banks in rural areas was declining, bank branches were becoming more numerous.[14] In 1986, almost 69 percent of the rural bank offices in California were controlled by urban-based bank organizations (banks and bank holding companies). The study viewed this trend as broadening the choices of rural borrowers and also noted that for many it raised concern about the loss of local decisionmaking for loans. In addition, rural focus group participants mentioned more stringent regulatory requirements as another factor in the credit difficulties of small businesses.

Rural focus group participants also noted difficulties in small businesses obtaining credit that were usually attributed, at least in part, to centralized and standardized decisionmaking and the scarcity of smaller banks. Under this type of decisionmaking, these participants believed that urban bank policies might be misapplied to rural markets.

For example, in Del Norte County, an urgent-care doctor's facility needed a $1.3 million loan to buy the property. One of the banks in town could justify lending only $950,000. According to a participant who was the administrator of a loan fund, the problem was that this bank analyzed the loan using criteria that were appropriate for an urban, not a rural, area. The bank emphasized the lease analysis in its decisionmaking and was concerned because there were few other potential occupants for this type of building should the facility fail and the building become vacant. In the participant's opinion, the bank should have focused instead on the cash flow of the urgent care center. Eventually, a smaller bank provided the entire amount.

[14]Deregulation and the Structure of Rural Financial Markets, Rural Development Research Report No. 75, Economic Research Service.

The Banking Structure and Small Business Lending in Washington

Since the introduction of interstate banking in 1987, when out-of-state holding companies first could acquire healthy banks in Washington, out-of-state acquisitions have left most of Washington's banking assets in the hands of large interstate banks. Because of their concerns over the planned merger between the two largest banks in the state, Seattle-First National Bank and Security Pacific Bank, regulators took action to ensure that the state's banking structure remained potentially competitive.

However, interstate banking did not alter the distribution of the market share of large and smaller banks.[1] Despite some reduction in number among smaller banks, the distribution of market share between large and smaller banks changed little from December 1984 to June 1993. Further, smaller banks as a group remained profitable.

Because many factors influence the availability of credit to small businesses, we were unable to determine whether interstate banking in and of itself made more or less credit available to small businesses. While interstate banking and branching has the potential to increase credit availability, some small business experts who work with small businesses on financing issues were concerned about how large banks were making their loans. As borrowers in some markets have become more reliant on large banks, the centralized and standardized decisionmaking practices used by these banks reportedly have made it more difficult for some small businesses to obtain credit. Some bankers, however, told us that overall centralization and standardization allow large banks to increase their total amount of small business lending.

Washington's Economy

Since becoming a state, Washington's economic growth rate has generally exceeded the growth rate of the nation as a whole. Its economy was the 17th largest in the nation in 1989, with the total value of goods and services produced within its borders totaling $96 billion.

The last 2 decades in Washington have generally been marked by strong economic growth. The state's economy has diversified beyond its primary goods-producing industries of aerospace, forest products, food processing, primary metals, and agriculture into other manufacturing and service

[1]In appendix II we used the term "large banks" to refer to those with assets of more than $10 billion. However, only one such bank existed in either Washington or Arizona for all but 1 of the years on which we focused. Therefore, in appendixes III and IV, we used the term "large banks" to refer to banks with assets of more than $1 billion. Thus, we do not discuss "midsized" banks in these appendixes. As we did in appendix II, we used current dollars to determine which categories banks belonged in and used constant dollars when comparing growth trends across several years.

industries. Moreover, real personal income growth for the state accelerated to 5 percent in fiscal year 1990, the strongest annual increase since the 1970s.

While Washington also experienced the effects of the national recession in 1992, the recession was not as deep or as prolonged as it was in California. For example, although the employment level declined in both states and in the nation in the early 1990s, Washington increased employment overall, despite losing jobs in some sectors. From 1990 through 1992, the nation's employment level decreased by more than 1 percent and California's decreased by nearly 5.4 percent, but Washington's increased by 3 percent.

Washington's Banking History

Washington passed interstate banking in two phases. In 1983, out-of-state bank holding companies could purchase failing in-state banks as long as no banks operating in the state were willing to purchase these failing banks under terms at least as favorable as those of the out-of-state bank holding company. In this manner, Bank of America acquired financially troubled Seattle-First National Bank in 1984 (commonly known as SeaFirst Bank), the state's largest bank.

The only other out-of-state banks in 1984 were a smaller bank, Western National Bank, and a large bank, First Interstate Bank Washington, which was also California based. First Interstate Bank entered the state before the Douglas Amendment to the Bank Holding Company Act of 1956 was passed.[2] As such, First Interstate Bank in Washington and several other states were grandfathered under this act. In 1984, the three out-of-state banks accounted for 39.7 percent of the state's banking assets.

All remaining banks in 1984 were in-state and consisted of

- four large banks with assets ranging from $1.3 billion to $7.3 billion that operated in either one-half of the state or statewide and
- ninety-five smaller banks, 86 of which had assets of less than $100 million and 9 with assets ranging from $100 million to $1 billion.

In 1987, the second phase of interstate banking began when Washington permitted out-of-state acquisition of any bank that had operated for 3 years or more, regardless of its financial condition, provided the acquiring bank was from a state that also permitted reciprocal out-of-state

[2]The Douglas Amendment prohibited bank holding companies from crossing state lines unless specifically permitted by the state the company wished to enter.

acquisitions. This phase began a string of acquisitions by out-of-state banks, the biggest of which was the merger between Security Pacific Corporation and BankAmerica Corporation, the parent holding companies of Washington's two largest banks. By mid-1993, 82.4 percent of Washington's banking assets were owned by out-of-state banks. Out-of-state bank holding companies owned all of the state's large banks and 4 of the 85 smaller banks.

Interstate Banking Has Not Increased Domination by Large Banks Statewide

Despite the influx of out-of-state banks, removal of interstate banking restrictions has not resulted in large banks consistently increasing their market share relative to smaller banks statewide. Table III.1 shows that there has been little change in the total market share of large and smaller banks when December 1984—about 3 years before Washington permitted interstate acquisition of healthy banks—is compared to June 1993.[3] However, table III.1 does show a substantial and steady shift to out-of-state ownership of large banks after 1987, when interstate acquisition of healthy banks was permitted.

Table III.1: Comparison of Market Share of Washington Banks by Size

	Percentage of market share of large banks			Percentage of market share of smaller banks		
Year	Interstate	In-state	Total	Interstate	In-state	Total
1984	39.67%	42.19%	81.86%	0.02%	18.11%	18.13%
1985	41.79	41.68	83.46	0.00	16.54	16.54
1986	40.52	42.68	83.20	0.16	16.64	16.80
1987	71.92	10.94	82.86	3.23	13.90	17.13
1988	75.40	6.33	81.73	4.06	14.22	18.28
1989	78.36	6.89	85.24	1.00	13.81	14.81
1990	77.22	7.06	84.28	1.00	14.71	15.71
1991	74.36	7.88	82.23	1.04	16.73	17.77
1992	73.48	7.62	81.10	0.67	18.23	18.90
1993[a]	81.75	0.00	81.75	.65	17.59	18.25

Note: Numbers may not add due to rounding.

[a]1993 data are as of June 30. All other data are as of December 31.

Source: FDIC call report data.

[3]In table III.1, the market share of large banks was measured on the basis of all banks with more than $1 billion in assets, and the market share of smaller banks was measured on the basis of all banks with $1 billion or less in assets.

Table III.1 also shows that out-of-state holding companies acquired several smaller banks, most notably in 1987 and 1988.[4] The decline of the market share of out-of-state smaller banks, beginning in 1989, occurred largely because one bank, Key Bank of Washington, became a large bank through acquisitions.

Profile of Large Out-of-State Banks in Washington

Although large banks as a group have not increasingly dominated Washington's banking market, major changes have occurred within the group. For example, several large banks grew between 1984 and mid-1993, usually through major acquisitions, while others disappeared as they were bought. As a result of these changes, some large banks have become more dominant within the state and this trend could continue.

We divided interstate banking in Washington into (1) the entry and expansion of out-of-state banks before BankAmerica Corporation merged with Security Pacific Corporation and (2) changes resulting from this merger. The merger was a watershed because it greatly altered the banking structure in Washington. In the state, after the merger, the largest bank increased its size by almost one-fourth, the second largest bank disappeared, and two smaller banks became more significant players.

Profile of Out-of-State Banks Before the BankAmerica/Security Pacific Merger

The five large out-of-state holding companies developed major institutions in Washington in one of two ways: (1) by establishing a sizable presence immediately by buying one or more large Washington banks or (2) by entering on a smaller scale by first buying several smaller banks and, once established, making larger acquisitions. Once in the state, when measured in 1992 dollars, three of the five banks grew moderately through 1991; one increased nearly eightfold in size over this time; and the fifth experienced a decline.

In 1984, BankAmerica Corporation bought financially troubled SeaFirst Bank. From the time of acquisition through March 1994, it has remained the state's largest bank. Overall, its growth was modest during this period, although in some years it expanded and in other years contracted. Table III.2 shows that, in 1984, when measured in constant 1992 dollars, it had $11.9 billion in assets and a market share of more than 30 percent. By

[4]Depending upon the year, between two and three holding companies that owned large banks also owned smaller banks. The trends in large bank market share do not change if these smaller banks are added into the large bank market share. The total market share of large banks, however, would increase while that of smaller banks would decrease. Depending upon the year, these changes ranged from .94 percent to 1.7 percent and averaged 1.3 percent.

1991, its assets increased to $12.5 billion, while its market share increased only slightly.

Table III.2: Entry of Major Out-of-State Banks Into Washington

Constant 1992 dollars in billions

Acquisition			Size of acquired bank in year of acquisition		Size of surviving bank in 1991	
Year	Acquiring bank holding company	Acquired bank	Assets	Market share	Assets	Market share
1984	BankAmerica Corporation	SeaFirst Bank	$11.9	30.2%	$12.5	30.3%
1987	Security Pacific Corporation	Rainier National Bank	10.1	24.3	7.3	17.7
1987	U.S. Bancorp	People's Bank and Old National Bank	3.1 2.2	7.3 5.0	5.5	13.5
1987	Keycorp	3 smaller banks	1.1	2.6	1.6	3.8
1988	West One Bancorp	1 smaller bank	0.03	0.08	0.3[a]	0.6

[a]West One Bank's actual size was $253 million in assets, which was rounded to $300 million in the table. Thus, it increased more than eightfold in size between 1988 (when it had approximately $300,000 in assets) and 1991 (when it had more than $250 million).

Source: FDIC call report data.

In 1987, Security Pacific Corporation, another California bank holding company, purchased the state's second largest bank, Rainier National Bank. Although it remained the second largest bank from 1984 through 1991, its assets and market share declined. It had $10.1 billion in assets and a market share of 24.3 percent statewide in 1984. By 1991, its assets had declined to $7.3 billion and its market share to 17.7 percent. (See table III.2.)

The Oregon holding company U.S. Bancorp also entered Washington in 1987 by buying the state's fourth and sixth largest banks—People's Bank and Old National Bank—whose combined assets totaled $5.3 billion. Regulators had little concern that U.S. Bancorp's acquisition of these two banks would affect competition in the state because the two banks operated in different parts of the state and thus served different customers.

After its acquisition of these two banks, U.S. Bank immediately became the third largest bank in the state. Between 1987 and 1991 it grew, in part, because its holding company purchased four smaller banks with assets totaling $345.2 million. By year-end 1991, U.S. Bank had assets totaling $5.5 billion and controlled 13.5 percent of the market. (See table III.2.)

Keycorp and West One Bancorp were different from BankAmerica Corporation, Security Pacific Corporation, and U.S. Bancorp. They entered Washington on a small scale in 1987 and 1988, respectively, by buying smaller banks and then made major acquisitions in 1992 and early 1993.

In 1987, Keycorp, a New York holding company, entered the state by buying three smaller banks with assets totaling $1.1 billion and a market share of 2.6 percent. As table III.2 shows, Keycorp's growth through 1991 was modest, with its assets increasing by $500 million and its market share by slightly more than 1 percent.

In 1988, West One Bancorp entered by buying one smaller bank with $30 million in assets and a market share of 0.08 percent. Through 1991, it bought three more smaller banks, which helped to increase its assets and market share more than eightfold. (See table III.2.)

Profile of Out-of-State Banks After the BankAmerica/Security Pacific Merger

In 1992, BankAmerica Corporation and Security Pacific Corporation, the two largest bank holding companies in the West, merged. The surviving bank in Washington, a subsidiary of BankAmerica Corporation, retained the name SeaFirst Bank and grew from a bank with $12.5 billion in assets and a 30.3 percent market share in 1991 to a bank with $15.4 billion in assets with a 37.4 percent market share in 1992. (See table III.3.) SeaFirst would have become larger, but state and federal regulators intervened. The second largest bank, as of mid-1993, was Key Bank of Washington, a bank with $6.7 billion in assets with a 16.3 percent market share.

Table III.3: Major Acquisitions Since 1991

Constant 1992 dollars in billions

Acquisition			Size of acquiring bank before acquisition		Size of acquiring bank after acquisition	
Year	Acquiring holding company bank	Acquired bank	Assets	Market share	Assets	Market share
1992	BankAmerica Corporation	Security Pacific Bank	$12.5	30.3%	$15.4	37.4%
1992	West One Bancorp	SeaFirst Bank divested branches	0.3	0.6	1.8	4.3
1992	Keycorp	SeaFirst Bank divested branches	1.6	3.8	3.0	7.3
1993[a]	Keycorp	Puget Sound National Bank	3.0	7.3	6.7	16.3

[a]1993 data are as of June 30. All other data are as of December 31.

Source: FDIC call report data.

In absorbing the second largest bank in Washington—Security Pacific Bank—SeaFirst Bank enhanced its position in the state's banking market. Before the merger, the gap between SeaFirst and the second largest bank was $5.2 billion in assets and 12.6 percent in market share. After the merger, the gap in assets between SeaFirst Bank and Key Bank of Washington, now the second largest, increased to $8.7 billion and the gap in market share increased to 21 percent.

State and federal regulators were concerned that this merger could be anticompetitive because SeaFirst Bank would dwarf its competitors. According to competition theory, when a market contains one large firm (be it a bank or any type of company) in the midst of smaller firms, the chances increase that the large firm can establish prices without fear of being undercut by the smaller firms, its competitors. To maintain the potential for competition in Washington, regulators obtained an agreement from BankAmerica Corporation that it would divest some of its branches to other banks, thereby shrinking SeaFirst while building up the acquiring banks as competitors. Had regulators approved the merger without this divestiture, SeaFirst Bank would have become $1.5 billion larger in assets than it had been as of mid-1993, an almost 10 percent increase.

Competitive concerns in Washington focused on two major areas, small- to medium-sized business lending and banking services in rural markets. According to Washington's Assistant Attorney General, SeaFirst Bank and

Security Pacific Bank provided a significant amount of small business loans in the state, and the amount of these loans could decline because the merger would cause a decrease in the number of loan providers. Also, rural areas were the most likely to be harmed by the merger because Security Pacific Bank and SeaFirst Bank were the primary competitors in many rural markets.

As a result of state and federal regulators reviewing the proposed merger, BankAmerica Corporation agreed to divest 86 branches in the state, many of which were located in rural areas, to other banks. The goal of this divestiture of branches, according to the Washington Assistant Attorney General, was to approximate the banking structure that had existed before the merger by creating larger institutions, with more of a statewide presence, that could take the place of Security Pacific Bank in competition against SeaFirst Bank.

As part of its merger review, the Department of Justice conducted an HHI analysis.[5] The results of this analysis led to BankAmerica Corporation divesting branches in 24 markets. Nine of these markets were above the 1,800 HHI cutoff before the merger and with the divestiture were projected to have either no change or a change of less than 45 points. In the remaining 15 markets, 6 experienced no change in the HHI after the divestiture, and 9 had a change of between –81 and 426 points. The largest increase of 426 points was in Seattle. Before the merger, its HHI was 1,340 and after the merger and divestiture it was projected to be 1,766. Although this was close to the 1,800 cutoff, there was no cause for concern, according to regulators, because a sufficient number of competitors existed.

Two bank holding companies, Keycorp and West One Bancorp, bought the 86 divested branches. West One, which primarily acquired branches in western Washington, is now the fifth largest bank in the state. From year-end 1991 to mid-1993, it grew from about $253 million in assets to $1.8 billion and from 0.6 percent in market share to 4.3 percent. It purchased 38 divested branches with $1.2 billion in deposits and more than $750 million in assets.

Key Bank of Washington catapulted from $1.6 billion in assets to become the second largest bank in the state, with $6.7 billion in assets and a 16.3 percent market share. Its holding company (1) acquired 48 divested

[5]HHI measures the concentration of market share. See appendix II for a background discussion on HHI.

branches from the BankAmerica/Security Pacific merger that consisted of $1.35 billion in deposits and more than $760 million in assets and (2) in early 1993, bought the state's last remaining large in-state bank, Puget Sound, with $3.1 billion in assets.

Keycorp's purchase of Puget Sound Bank did not cause anticompetitive concerns on the part of regulators because the two banks tended to operate in different markets. Thus, in most of these markets, no providers of financial services were lost. In the few markets where the two banks' operations overlapped, government officials felt sufficient competition would continue despite the merger.

At the time of our review, there had not been any studies as to whether the BankAmerica Corporation/Security Pacific Corporation merger had impaired competition, according to antitrust regulators. One official told us that the degree of competition will depend on how Key Bank and West One Bank operate the divested assets and, at the time of our review, this was too early to assess.

Smaller Banks Had a Continued Strong Presence

Smaller banks remained a viable segment of Washington's banking industry, as evidenced by trends in new smaller bank entry, market share, and profitability. Although their numbers declined, primarily because of healthy acquisitions by out-of-state and in-state banks, new bank entry had offset much of the consolidation.

When the state lifted interstate banking restrictions less than a decade ago, smaller banks often became desirable acquisition targets. Their persistence, as evidenced by trends in new smaller bank entry, market share, and profitability nevertheless showed that they successfully competed against large banks entering the state, at least within the first decade after interstate banking restrictions were lifted.

Consolidation of Smaller Banks

The number of smaller banks in Washington declined from a high of 96 in 1984 to a low of 88 in 1992, mainly because healthy banks were absorbed by larger banks during this period. Table III.4 shows that in 1985 and 1986 there were more in-state than out-of-state mergers. Some of these mergers resulted in the replacement of one bank with another because the acquirer was not previously present in the market. This was always the case when an interstate bank holding company made its first acquisition. Subsequent acquisitions, however, resulted in the disappearance of a smaller bank within the state because both the acquirer and acquired were already operating within its borders.

Table III.4: Number of Mergers and New Charters Involving In-State Smaller Banks, 1985-1992

2-year period	Out-of-state mergers	In-state mergers	New banks
1985-1986	3	9	3
1987-1988	9	4	5
1989-1990	4	3	11
1991-1992	1	2	7
Total	**17**	**18**[a]	**26**

[a]The assets from 13 of the 18 in-state acquisitions were owned out-of-state as of June 30, 1992, due to subsequent purchases of the in-state acquirers by out-of-state bank holding companies.

Source: FDIC call report data.

After the state passed reciprocal interstate banking in 1987, out-of-state acquisitions became more frequent for a time and then decreased. In all but one instance, the acquirer was one of three large out-of-state holding companies: U.S. Bancorp, Keycorp, or West One Bancorp. These acquisitions were of healthy banks, whereas the three out-of-state purchases from 1985 through 1986 were of failed banks, the only type of bank that Washington permitted out-of-state bank holding companies to acquire at that time.

New bank entry offset much, and in some years all, of the decline in the number of banks in the state. New entry was especially strong in the late 1980s through early 1990s. (See table III.4.) The formation of these banks indicated that interstate banking did not necessarily threaten smaller banking in the first years after interstate banking restrictions were lifted.

Smaller Banks Remained Viable Despite Consolidation

Consolidation among smaller banks by no means signaled the beginning of their demise in the state. After the state removed interstate banking restrictions in the mid-1980s, changes in this group's market share were minimal and its return on assets either remained stable or improved.

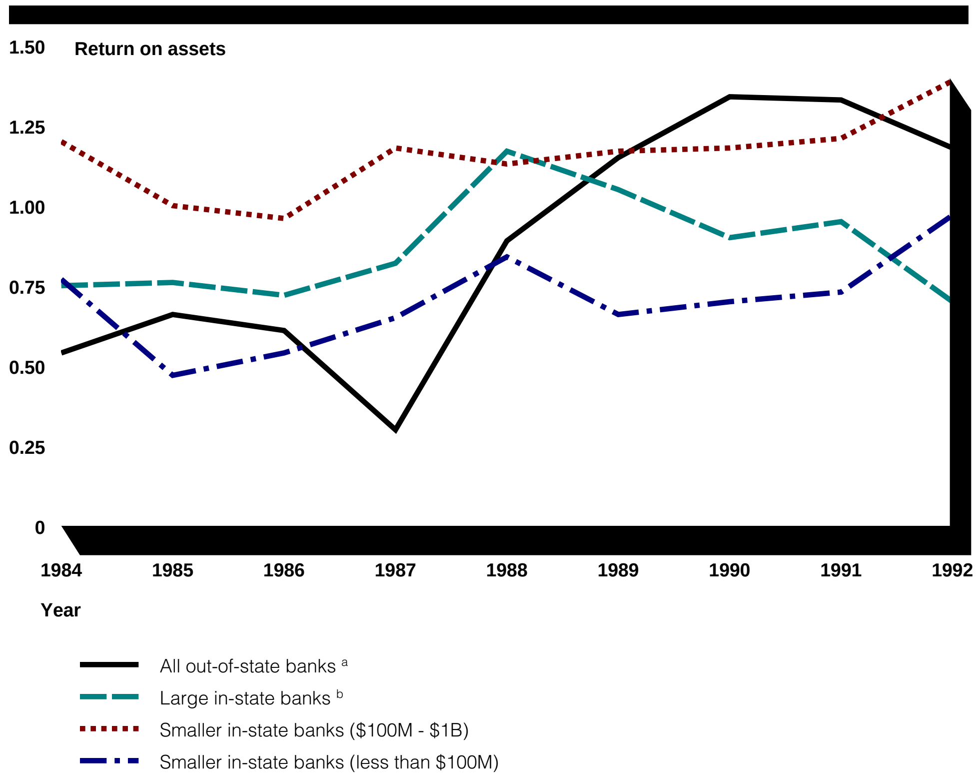
Smaller banks' market share increased slightly, from 18.1 percent in 1984 to 18.25 percent by mid-1993, after interstate banking began in Washington. The market share of smaller banks owned within the state, however, declined once interstate banking legislation passed. As shown in table III.1, the decline mostly took place during the years 1984 through

1987, when the state was removing interstate banking restrictions. In the early 1990s, new smaller bank entry and growth of existing smaller banks offset this initial decline.

While smaller banks as a group were recapturing market share, a divergent trend was occurring within the group. For example, the market share held by banks with under $100 million in assets declined from 9.8 percent to 6.4 percent, while the market share for banks with assets from $100 million to $1 billion increased from 8.3 percent to 11.8 percent.

Interstate banking appeared not to have impaired the profitability of smaller banks in Washington when measured by in-state and out-of-state return on assets. Figure III.1 shows that in-state smaller banks with assets from $100 million to $1 billion earned the most consistently strong ROAS from 1984 through 1992, followed by large in-state banks with assets of more than $1 billion. Although smaller in-state banks with assets of less than $100 million typically had the lowest ROAS, they maintained positive ROAS and on occasion surpassed the out-of-state banks and large in-state banks. These results may have had more to do with the relationship between profitability and bank size than with the removal of interstate banking restrictions.

Figure III.1: ROA for Out-of-State Versus In-State Washington Banks



[a]Out-of-state banks included smaller banks and large banks. The number of smaller banks ranged from 0 to 7 depending on the year. Most were owned by bank holding companies of the large out-of-state banks and were operated separately from them for a period of time.

[b]From 1987 through 1992, Puget Sound was the only large in-state bank.

Source: FDIC call report data.

In addition, as shown in table III.5, the profitability of in-state smaller banks did not decrease after interstate banking was introduced. It shows that these banks had higher ROAs after the state passed reciprocal interstate banking laws than they did before. Although many factors influence ROA, making it difficult to assess the effect of interstate banking in a simple before-and-after comparison, it is nevertheless interesting that no negative effect is discernible.

Table III.5: ROA Comparison Before and After Interstate Banking

	3-Year average ROA for smaller banks	
Interstate banking status	Large in-state smaller banks[a]	Small in-state smaller banks[b]
Before 1984-1986	1.04%	0.59%
After 1987-1989	1.16	0.72
After 1990-1992	1.27	0.80

[a]From $100 million to $1 billion.

[b]Less than $100 million.

Source: FDIC call report data.

Small Business Lending in Washington Under Its Interstate Banking Laws

During our discussions in selected local markets in Washington, we were told that some small businesses may have been having difficulty in obtaining loans. As in California, however, we were unable to determine if this was the direct result of removing geographic restrictions, because other factors, such as regulation, may have played a role in credit availability problems.

Nevertheless, by-products of in-state and interstate geographic deregulation, namely industry consolidation and standardized and centralized loan decisionmaking practices of large banks (which in Washington are interstate banks) led some small business experts, bankers, and government officials to have the following concerns:

- Will small businesses become more dependent on large banks for credit as the industry continues to consolidate?
- If so, will these large banks have the necessary flexibility to meet all small business needs?

Others, such as bankers from large banks, however, responded to these concerns by noting that large banks were becoming much more active in the small business market.

Data on Small Business Lending Is Incomplete

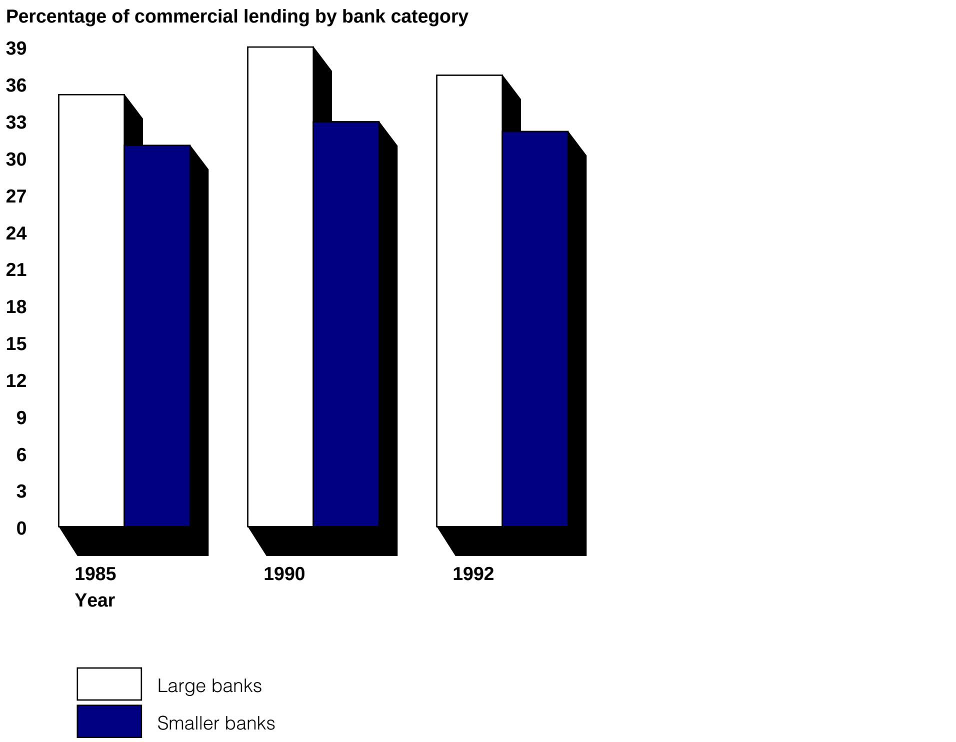
As in California, our first step in collecting information on whether unrestricted branching had affected small business lending in Washington was to ascertain which category of bank was the more common provider of small business loans—large banks with extensive branch networks or smaller banks. The most complete sources of information available on small business lending in Washington were call reports and SBA data. Neither of these sources, however, gave a complete picture of small business lending. Call reports were limited because the data included all commercial lending, until June 1993, when outstanding small business loans were separately categorized.[6] SBA data were limited because the data only pertained to one type of small business lending, loans backed by an SBA guaranty. Although analyzing these two information sources neither reflected the total amount of small business lending nor established conclusively which categories of banks were the most common providers of small business loans, the information provided us with an insight into commercial lending.

Our analysis of call report data from 1985 through 1992 indicated that large banks made more loans (both consumer and commercial), as a percentage of assets, than did smaller banks. For example, in 1992 large banks invested 74 percent of their assets in loans, compared to 57 percent for smaller banks.

Figure III.2 shows that depending upon the year, large banks had invested about 35 percent to 39 percent of their assets in commercial loans, and smaller banks had invested about 31 percent to 33 percent.

[6]For a discussion of limitations pertaining to the 1993 call report data on small business lending, see appendix II.

Figure III.2: Percentage of Assets in Commercial Lending in Washington



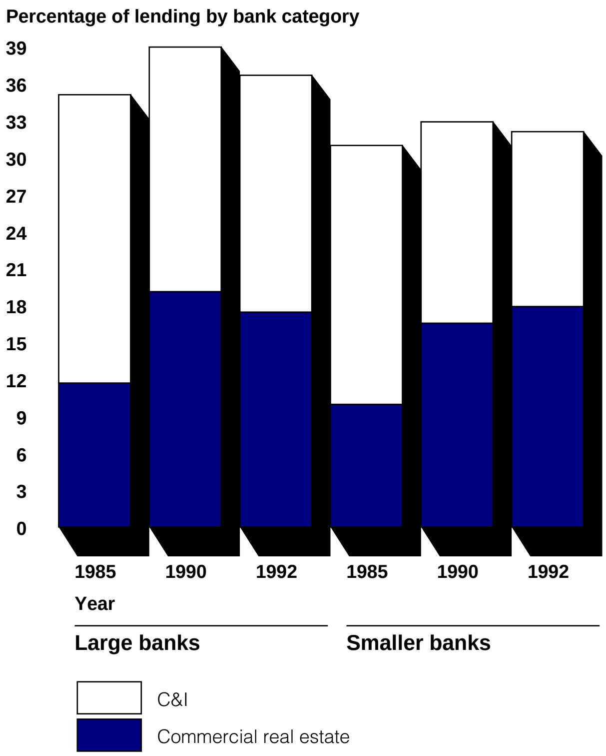
Note: Commercial lending included C&I loans and commercial real estate loans.

Source: FDIC call report data.

Regarding the type of commercial bank lending, figure III.3 shows that large banks usually made more C&I and commercial real estate loans than did smaller banks.[7] The only exception was 1992, when both made a similar amount of commercial real estate loans, about 17.5 and 18 percent respectively. The figure also shows that both large and smaller banks decreased their C&I lending and increased their commercial real estate lending over the period, with smaller banks having the greater changes.

[7]C&I loans are commercial loans that were secured by something other than real estate or were unsecured. Commercial real estate loans were commercial loans that were secured by commercial real estate.

Figure III.3: Commercial Lending in Washington



Source: FDIC call report data.

Our analysis of the quarterly June 1993 call report data on small business lending showed that large banks devoted a greater dollar amount than smaller banks to small business lending (i.e., C&I and commercial real estate loans) during the 3 months, but that smaller banks devoted a greater portion of their assets to small business lending than large banks. Large banks had $4.1 million in small business loans or 12.4 percent of their assets. Smaller banks, on the other hand, had a total of $1.5 million in small business loans or 20.7 percent of their assets. Moreover, this pattern did not change when C&I loans and commercial real estate loans were analyzed separately.

As for SBA lending, table III.6 shows that, as in California, smaller banks were the strongest lenders. However, large banks accounted for a much higher percentage of total SBA loans, and nonbanks a lower percentage, than they did in California.

Table III.6: SBA Lending by Type of Institution in Washington, 1988-1992

Type of institution	Number of loans	Percentage of total
Smaller banks	1,358	51.8%
Large banks	854	32.6
Nonbanks	368	14.0
Thrifts and saving banks	41	1.6
Total	**2,621**	**100.0%**

Source: SBA data.

The top SBA lenders in Washington from January 1988 to June 1992 were two large banks, Security Pacific and U.S. Bank, followed by a nonbank and two smaller banks. However, Security Pacific's percentage of total SBA loans declined over the period, from 26 percent in 1988 to 3.3 percent in 1992, while that of U.S. Bank increased from 7.5 percent to 18.8 percent.

According to an SBA official, a bank's participation in the SBA program depends upon its priorities; thus it is not surprising that subsidiaries of a given bank holding company in different states vary in their amount of SBA lending. For example, SBA officials told us that U.S. Bank has been an active SBA lender in Washington from the time it first entered the state to the time of our review. However, U.S. Bancorp's original subsidiary in Oregon made little use of the SBA program over this time period.

Other Sources of Small Business Lending

Small businesses may also seek credit from loan funds managed by state and city governments and private, nonprofit agencies. One program, for example, made 96 loans totaling $34.1 million in a little over 2 years. In another example, the city of Spokane began a small business loan program in 1991 for loans of less than $50,000. According to its administrator, the program had filled a gap left because banks did not find it economically viable to make small business loans of less than $50,000. The administrator estimated that almost $1.7 million in loans were funded in 2 years.

Trend Toward Centralized and Standardized Loan Decisions

According to officials, interstate banks in Washington made small business loans in much the same way that large banks with statewide branch networks did in California. That is, they used centralized and standardized decisionmaking practices to make a large volume of low cost loans.

The majority of small business lending decisions are made in the state where the loan originates, according to an official at one of the Washington interstate banks. However, the broad policies and procedures governing these decisions tend to be formulated out-of-state at corporate headquarters with input from state subsidiary banks.

Some examples of policies formulated at the corporate level are "concentration ratios" and "risk ratings" of industries. Concentration ratios measure how much of a bank's loan portfolio can be concentrated within a particular type of lending, for example, real estate. Risk ratings classify industries as those that are the most or least desirable to lend to, on the basis of the overall health of the particular industry. In the case of interstate banks, a corporate headquarters may stipulate the concentration ratios and industry risk ratings used by its subsidiary banks in the various states of operation.

Officials at the interstate subsidiary banks in Washington said they did not automatically deny a loan that was for a risky industry or was of a type in which the bank's loan portfolio was already heavily concentrated. Rather, they may have (1) carefully reviewed such loans, (2) refrained from actively pursuing such loans, or (3) continued to fund these types of loans for existing customers who had a history of repayment with the bank but generally denied them to new applicants.

Centralization and Standardization May Affect Credit Availability

To better understand credit availability concerns in Washington, we focused on four markets[8] to ascertain whether small businesses were having difficulty obtaining loans and what role, if any, interstate banking and industry consolidation played. We (1) held focus group discussions in each market with individuals who worked closely with small businesses on financing issues, (2) interviewed regulators, and (3) interviewed officials from interstate and smaller banks who were major providers of small business loans.

Most of the focus group participants and some bankers in all four markets reported that certain types of small businesses were experiencing increased difficulty obtaining loans. These difficulties were similar to those reported in California. That is, some businesses that formerly could get credit could no longer do so, and others could do so only after approaching several banks.

[8] The markets were Seattle, Spokane, Olympia, and Yakima. Appendix I briefly describes them.

Two possible reasons for increased difficulties indirectly linked to interstate banking and branching were mentioned: (1) centralized and standardized decisionmaking practices of large banks and (2) mergers that caused strong business lenders to disappear in some communities. Additional reasons were cited that were unrelated to interstate banking, such as the tightening of bank regulation. The economy, however, was generally not cited as a major factor in credit availability problems. This may have been because Washington's economy remained relatively healthy throughout most of the 1980s and early 1990s.

Two types of centralized and standardized decisionmaking practices were mentioned—loan decisions and policies set at a corporate level. Bankers from smaller banks and focus group participants frequently told us that centralized and standardized practices hurt some small businesses seeking credit in much the same way as was reported in California. These practices depersonalized the relationship between the loan applicant and the banker making the decision, thereby creating difficulty for certain businesses that did not meet the banks' preestablished criteria. Focus group participants and some bankers told us that centralized and standardized decisionmaking practices often did not allow the flexibility found in "relationship banking," in which local market conditions, unique business needs, and the character of the loan applicant were assessed.

In regard to policies set at a corporate level, which in Washington usually meant in another state, a frequent complaint concerned requirements that loan officers more closely evaluate applications for loans in industries that the corporate level designated as risky. Some focus group participants and bankers believed that these closer evaluations impeded lending even for the "good deals" in these industries. Participants also speculated that some corporate level restrictive policies may have been driven by bank subsidiary experiences in other states and therefore should not be applied to banks in Washington, where the economy had remained relatively healthy.

Two focus group participants related the following experiences to illustrate how centralized and standardized loan practices or loan decisions can hinder small businesses seeking credit.

One local government official who helped small businesses obtain financing in the Tacoma area, found large interstate banks less willing than smaller banks to fund risky industries, such as those related to timber or those located near areas with environmental problems. Interstate banks, she believed, had such a steady stream of applications that they could afford to fund those that presented the least risk and devote less time and effort to evaluating the riskier applications. She found smaller banks more receptive to these types of applications because these banks took the time to analyze each loan application, taking into account, for example, the results of environmental impact studies.

One loan fund administrator in Spokane described a restaurant that had successfully been in business for 20 years. The restaurant had approached three or four banks before finding a loan officer at an interstate bank who agreed to fund the loan with an SBA guaranty. First, however, the loan officer had to send the application to his managers for final approval because the restaurant industry was classified as high risk. On the basis of the experience of restaurants in major cities, such as Portland and Seattle, the managers denied the loan, which was eventually provided by a smaller bank in Spokane.

Several bankers from large banks also agreed that centralization and standardization can result in certain loan applicants being denied loans. One such banker noted that this problem especially affected rural areas because centrally located decisionmakers did not understand the businesses or industries in such areas.

The types of businesses regarded as susceptible to credit availability problems by focus group participants and some bankers were similar to those described in California. They included

- businesses that were not easily understood by bankers and did not fit easily into banks' standardized criteria, such as nonprofit firms;
- businesses needing certain types of loans, such as loans of less than $100,000 or unsecured working capital lines; and
- well-run, established businesses in "high-risk areas," which in Washington included commercial real estate, timber and fishing industries, and general business start-ups.

Several bankers we spoke with from Washington's interstate banks echoed the views of California's large bankers. These bankers said that centralization and standardization practices had allowed banks with extensive branch networks to become more active in the small business market because these practices lowered the banks' administrative costs of providing small business loans. Although this may be the case, focus group participants felt that there were still some small businesses that were not being served. This may have been because these participants tended to work with small businesses that did not easily fit standardized criteria.

Industry Consolidation May Have Varying Effects on Credit Availability

A second effect on small business credit availability indirectly linked to interstate banking and branching was industry consolidation through mergers. The focus groups and bankers from smaller banks cited two differing effects of mergers on small business credit availability:

- Some mergers were seen as increasing the funds available to small businesses. For example, a Yakima participant viewed a recent purchase of a smaller bank by an interstate bank as positive because the acquirer was a strong business lender and should bring more capital into the area.
- The more common opinion, however, was that mergers involving large banks, most of which were interstate, tended to make less credit available to small businesses within a local area because (1) large banks were less interested in small business loans or (2) newly merged banks had different lending philosophies than did smaller banks.

Several focus group participants stated that when large banks entered a rural area and took over their branches, the large banks were interested in consumer lending and deposits, rather than in commercial lending. According to the focus groups, rural areas in particular witnessed large banks decreasing their commercial lending. For example, one focus group participant described a successful business that had maintained deposits at a large bank for 25 years. When the business applied for an expansion loan at the bank, which had recently merged, the application was denied. An in-state bank eventually provided the loan.

Because data were only available on an aggregate basis, we could not determine what loans were made within local markets or to what types of businesses these loans were made. However, we did look at the aggregated data to determine whether banks acquired by out-of-state bank holding companies had changed their total loans or their overall lending strategy. To do so, we examined the total value of loans made by out-of-state banks after they acquired one or more in-state banks. Unfortunately, our analysis cannot confirm or refute focus group perceptions because it aggregated the lending of these banks, while focus groups tended to discuss lending in local markets.

We did an analysis[9] and looked at the loan portfolios of banks acquired by Security Pacific Bank, U.S. Bank, and Key Bank of Washington to determine the yearly average of these loans from 1984 through 1986, when these banks entered Washington. We compared these yearly loan averages with the yearly average loans made by their new subsidiaries—Security Pacific Bank, U.S. Bank, and Key Bank of Washington—during 1988 through 1992. Specifically, we looked at C&I, commercial real estate, and consumer loans (see table III.7).

Our analysis shows that Security Pacific Bank made fewer loans than the bank its holding company acquired, while U.S. Bank and Key Bank of Washington made more loans than the banks their holding companies acquired. Moreover, each of the three banks differed in the types of loans they focused on. Security Pacific Bank made fewer C&I and consumer loans than Rainier Bank, but significantly more commercial real estate loans. The increased lending provided by U.S. Bank was fairly evenly distributed among C&I loans, commercial real estate loans, and consumer loans. Finally, Key Bank of Washington, although it provided more loans in all three categories than did its acquired banks, focused particularly on consumer loans. (See table III.7.)

[9]We considered 1987—the year that these banks entered the state—to be transitional and thus excluded it from our analysis. Also, we did not include West One Bank, First Interstate Washington, and SeaFirst Bank in our analysis. From 1988 though 1990, West One Bank entered the state by acquiring only smaller banks, and not enough years had passed for us to make a valid comparison. At the end of 1984—the first year of our review—First Interstate Washington and SeaFirst Bank were already operating in the state.

Table III.7: Comparison of Average Annual Lending Patterns of Out-of-State Banks With Their Acquired Banks

Constant 1992 dollars in millions

	Average annual lending			
Acquired bank (1984-1986) New subsidiary (1988-1991)[a]	Total	C&I	Commercial real estate	Consumer
Rainier National Bank	$6,970	$2,166	$944	$1,851
Security Pacific Bank[b]	6,503	1,621	1,899	1,803
People's National Bank & Old National Bank	3,512	1,188	613	1,207
US Bank[c]	4,176	1,478	917	1,313
Seattle Trust and Savings Bank, Northwest Bank, and Cascade Security Bank	658	134	134	275
Key Bank of Washington[d]	971	173	243	540

[a]We included 1992 data for U.S. Bank. Data for 1992 was not relevant for Security Pacific Bank, because it was acquired by BankAmerica Corporation, or for Key Bank of Washington, because the 1992 figures included the divested assets it purchased from BankAmerica Corporation.

[b]In 1986 Security Pacific Corporation also purchased a failed smaller bank, which had loans of $10.7 million at year-end 1985.

[c]U.S. Bancorp also acquired two smaller banks in 1988, which had loans of $70 million at year-end 1987.

[d]Keycorp also acquired one smaller bank in 1990, which had loans of $64 million at year-end 1989.

Source: FDIC call report data.

We were unable to determine if changes in the amount of lending before and after acquisitions was due to interstate banking because many factors, such as the economy, influence lending.

Credit Availability Problems Reported in Certain Types of Markets

Focus group participants and some bankers said that centralization, standardization, and industry consolidation were problems in markets where they felt there were insufficient credit alternatives to large banks. For example, all of the focus groups and many bankers from smaller banks viewed unmet credit demand as a problem in rural areas. Several individuals explained that because outlying areas could have a difficult time supporting more than one bank, these areas would have no credit alternatives to branches of the large, interstate banks. Moreover, high capital requirements often made it difficult to start new banks in these areas.

Spokane and Olympia focus group participants noted that few credit alternatives to large banks existed in the outlying rural areas surrounding their cities. The Olympia group also mentioned that many of the rural smaller banks that were thriving had very small capital bases. Thus, some nonstandard businesses may have had difficulty obtaining loans over the lending limits of rural smaller banks that had more flexible decisionmaking processes than did the large banks. In addition, the Seattle focus group noted that loan programs tended to be available in urban rather than rural areas.

Overall, few concerns about urban areas were expressed in Washington focus groups. This may have been because during the time of our review smaller banks as a group within Washington remained relatively healthy because of Washington's strong economy. Thus, concerns about smaller banks making fewer small business loans than they had in the past did not arise.

However, some Washington focus group participants said they thought credit availability in urban areas was a problem, while others did not. For example, most participants in the Spokane focus group thought that most small businesses in Spokane could eventually find funding. Most in the Seattle group, however, felt that there was unmet credit demand within both urban and rural areas. This difference of opinion may be attributable to the amount of alternative financing available to small businesses in these three areas. That is, although both Spokane and Seattle have nonprofit loan funds, Spokane is a much smaller city; thus, its nonprofit funds may be better able to meet any creditworthy demand not funded by banks or other financial institutions.

The Banking Structure and Small Business Lending in Arizona

Although it is not possible to separate the effects of interstate banking from those of Arizona's recession, the interplay between these two forces has altered Arizona's banking structure. Out-of-state bank holding companies acquired nearly all large banks and a substantial portion of smaller banks in the state. The merger between BankAmerica Corporation and Security Pacific Corporation raised concerns in Arizona, as it did in the other states we studied, and again regulators interceded to prevent undue concentrations in specific bank markets.

While smaller banks lost market share to the large, mostly interstate banks during the state's economic decline, their resurgence, beginning in the early 1990s, showed that they can maintain a viable presence.

As in the other two states we reviewed—California and Washington—many factors influence small business credit availability. Therefore, we were unable to determine whether interstate banking in and of itself made credit more difficult for small businesses to obtain. Nevertheless, two indirect consequences of interstate banking—centralized and standardized decisionmaking and bank industry consolidation—were reported by focus group participants and some bankers to have made it more difficult for some small businesses to obtain credit. Others, however, believed that these consequences could increase small business credit. Difficulties were mainly reported in markets where there might have been insufficient alternatives to large banks.

Arizona's Economy

Between the 1950s and the first half of the 1980s, Arizona was recognized as one of the fastest growing states in the nation. As people and companies moved to Arizona, retail trade, business and consumer services, financial services, and real estate rapidly grew to serve the increasing population and businesses.

After decades of rapid growth, Arizona experienced an economic slowdown in the latter half of the 1980s. The state's economic growth rate began to deteriorate in 1986, dropping well below the state's historical average by 1988. Further deterioration occurred in 1990 and 1991, in conjunction with the national recession.

In the early 1980s, a boom occurred in commercial real estate and construction. Rapidly, an out-of-equilibrium situation developed, with real estate values rising to unsustainable levels and over-building leading to high vacancy rates. The crash began in the late 1980s. Vacancy rates remained unusually high in 1993. The over-building and high vacancy rates contributed to financial industry woes, particularly the demise of the thrift industry, and economic difficulties for businesses and individuals.

As we mentioned, Arizona's economy experienced economic problems in the late 1980s, well before the national recession began in 1990, such as the collapse of its real estate and financial industries markets. However, Arizona has started its economic recovery.

Arizona's Banking History

In 1986, Arizona passed full nationwide interstate banking, with the stipulation that interstate banks could enter only by buying existing institutions.[1] According to industry experts, at the time no one anticipated that interstate banking would save the banking industry in Arizona from the effects of the economic downturn that was to follow.

From the late 1980s through 1990, the banking industry, which invested heavily in real estate loans, felt the most serious effects of the downturn. During this time, interstate banks that had already entered the state contributed much-needed capital to their Arizona subsidiaries, while others entered by acquiring failed institutions. Thus the collapse of Arizona's banking industry was prevented by interstate banking.

By June 1993, out-of-state holding companies owned 88.4 percent of Arizona's banking assets. Their subsidiaries included all five large banks with assets of more than $1 billion, except one recently formed to purchase the BankAmerica Corporation divestiture, and 12 of the 32 smaller banks in the state.

Interstate Banking and Economic Cycles Altered Market Share of Large and Smaller Banks

The fluctuating market share trends of large and smaller banks[2] reflected the effects of Arizona's boom-and-bust economy, the passage of interstate banking, and the fact that interstate banks were active acquirers of both large and smaller banks. Through 1987, smaller banks gained market share at the expense of large banks. This coincided with Arizona's real estate boom and occurred largely because out-of-state banks entered the smaller

[1]The law allowed "de novo" entry after June 30, 1992.

[2]The market share of large banks was based on all banks with more than $1 billion in assets, and the market share of smaller banks was based on all banks with $1 billion or less in assets.

bank category through acquisition and then increased the market share of those they acquired.[3]

Table IV.1: Market Share Comparisons of Arizona Banks

	Percentage of market share					
	Large banks			Smaller banks		
Year	Interstate	In-state	Total	Interstate	In-state	Total
1984	26.6%	62.5%	89.1%	0.0%	10.9%	10.9%
1985	24.9	63.9	88.8	0.0	11.2	11.2
1986	39.8	46.8	86.6	6.9	6.5	13.4
1987	49.6	35.9	85.5	9.0[a]	5.5	14.5
1988	52.5	36.1	88.6	5.9	5.5	11.4
1989	53.0	35.5	88.5	6.7	4.8	11.5
1990	61.4	28.9	90.3	6.5	3.2	9.7
1991	63.0	27.1	90.1	5.5	4.4	9.9
1992	60.2	28.8	89.0	4.6	6.3	10.9
1993[b]	83.6	4.8	88.4	4.8	6.8	11.6

[a]Includes the only foreign bank in Arizona from 1987 through 1993. It was a smaller bank and in 1993 it had .2 percent of the market.

[b]1993 data are as of June 30. All other data are as of December 31.

Source: FDIC call report data.

The economic collapse in Arizona occurred in the late 1980s and, as the table shows, large banks increased in market share as smaller banks decreased, with the increases occurring from 1987 through 1988 and from 1989 through 1990. Three "newly entered" interstate banks were primarily responsible for these increases: Security Pacific Bank Arizona, Citibank Arizona, and Bank of America Arizona.

By June 1992, smaller banks were once again gaining in market share and large banks were losing, coinciding with the improving Arizona economy.

Interstate Banking Has Changed Ownership of Large Banks

Interstate banking in Arizona resulted in out-of-state ownership of every major bank but one. Over the period we studied, after the introduction of interstate banking, some interstate banks became a major presence in the state, while others declined or remained more moderate in size within the state, and still others were acquired.

[3]Two major out-of-state banks were primarily responsible for increasing the market share of smaller banks between 1986 and 1987, Chase Bank of Arizona and Citicorp Arizona. Their entry and growth patterns are discussed later in this appendix.

Table IV.2 shows when the major banks entered Arizona, the institutions they initially acquired, and the percentage of the state's banking assets they controlled as of June 1993. Except for three thrifts purchased by BankAmerica Corporation, all acquisitions were of institutions that had not failed.

Table IV.2: Entry of Out-of-State Banks Into Arizona

Constant 1992 dollars in billions

	Acquisition		Size of subsidiary in year of acquisition		Size of subsidiary in June 1993	
Acquiring bank holding company	**Year**	**Acquired bank[a]**	**Assets**	**Market share**	**Assets**	**Market share**
First Interstate Bancorp	1877	N/A[b]	N/A[b]	N/A[b]	$7.1	19.4%
Security Pacific Corporation	1986	The Arizona Bank	$5.8	16.2%	8.1[c]	22.0[c]
Citicorp	1986	Great Western Bank	1.0	2.9		
	1988	United Bank of Arizona	3.4[d]	10.0[d]	2.3	6.3
Chase Manhattan Corporation	1986	Continental Bank	1.0	2.7	0.5	1.5
BankAmerica Corporation	1990	Sun State Savings & Loan Association, MeraBank Federal Savings Bank, and Western Savings & Loan Association	6.0	16.9		
	1992	Security Pacific Bank Arizona	8.1[e]	22.0[e]	10.4[f]	28.3[f]
Bank One Corporation	1993	Valley National Bank of Arizona	10.5	28.8	10.9	29.7

N/A - Data not available.

[a]Includes thrifts.

[b]First Interstate Bancorp did not acquire a bank in Arizona from 1984 through 1992, our period of study.

[c]Size as of year-end 1991, Security Pacific Bank's last year of operation before its merger with BankAmerica Corporation.

[d]Includes the size of Citibank after the purchase of Great Western Bank.

[e]Size of Security Pacific in 1991, before its merger with Bank of America Arizona.

[f]The size of Bank of America Arizona after its merger with Security Pacific.

Source: FDIC call report data.

As of June 1993, First Interstate Bancorp of California was the bank holding company for the state's oldest major bank and its third largest, First Interstate Bank Arizona. It entered the state in 1877 and was grandfathered under the Douglas Amendment to the Bank Holding

Company Act of 1956. It steadily lost market share during both the economically prosperous times of the mid-1980s and the subsequent economic downturn. In 1984, it had about 27 percent of the banking market and in June 1993, about 19 percent.

The other longstanding bank in the state, established at least a century ago, was Valley National Bank of Arizona. In all except 1 year, it was the state's largest bank until it was acquired in 1993 by Bank One Corporation, an Ohio based bank holding company.[4] Valley National Bank of Arizona, similar to First Interstate Bank Arizona, steadily lost market share but its decline was more dramatic. Its share of the market fell from 40 percent in 1984 to 29 percent by 1992. By June 1993, the newly acquired bank, Valley National Bank, now known as Bank One, had $10.9 billion in assets and nearly 30 percent of the banking market.

For the most part, the three bank holding companies entering in 1986 (Security Pacific Corporation, Chase Manhattan Corporation, and Citicorp) exhibited similar trends: increasing in size and market share when first entering the state and decreasing in size and market share during the economic downturn. Decreases in size and market share did not necessarily mean, however, that resources were being taken out of the state. In fact, out-of-state bank holding companies were contributing capital to their Arizona subsidiaries to ensure their viability.

Security Pacific Corporation was the only one of the three bank holding companies to establish an immediately sizable presence because it acquired the state's third largest bank—The Arizona Bank, which became known as Security Pacific Bank Arizona. Over the next 2 years, Security Pacific Bank Arizona remained the state's third largest bank, increasing by more than $550 million in assets and 2.5 percent in market share. Although it continued to be the state's third largest bank, by 1990, it was slightly smaller than it was when it entered in 1986, with $5.5 billion in assets and 15.6 percent in market share. It was also the only major bank to grow in 1991, increasing to its largest size before its merger with BankAmerica Corporation in 1992.

Citicorp, in contrast to Security Pacific Corporation's immediately establishing a large presence, initially entered when its bank holding company purchased Great Western Bank, with $1 billion in assets and almost 3 percent in market share. Great Western Bank became known as

[4]Bank One is now the largest bank in Arizona.

Citibank Arizona.[5] This purchase made Citibank Arizona the fifth largest bank in the state. Two years later, in 1988, Citibank Arizona tripled in size and became the fourth largest bank because its bank holding company purchased a bank with close to $3 billion in assets and 8.6 percent in market share. Citibank Arizona also declined in assets and market share once the state encountered economic problems. Between 1988 and mid-1993, Citibank Arizona's assets and market share had declined by approximately one-third. (See table IV.2.)

In 1986, Chase Manhattan Corporation was the last major bank holding company to enter the state when it bought Continental Bank, a smaller bank, with about $1 billion in assets and 2.7 percent in market share. Continental Bank became known as Chase Bank of Arizona. Through mid-1993, Chase Bank of Arizona fluctuated between being the fifth and seventh largest, with a maximum of almost $1.2 billion in assets and 3.4 percent in market share in 1987. From the late 1980s through June 1993, it lost about 50 percent of its assets and market share. (See table IV.2.)

In 1990, BankAmerica Corporation entered Arizona by buying three failed thrifts. Its bank, Bank of America Arizona, immediately became the third largest bank in the state, with $6 billion in assets and about 17 percent in market share. By chartering a bank out of the assets of failed thrifts, Bank of America Arizona increased financial assets owned by banks and boosted the market share of large banks by about 2 percent. In 1992, it became Arizona's largest bank when its bank holding company acquired Security Pacific Bank Arizona. This acquisition approximately doubled its size in constant dollars to $12.6 billion in assets and 34.7 percent in market share in 1992.

This increase in size was only temporary, however, because BankAmerica Corporation agreed to divest itself of 49 branches (consisting of $1.6 billion in deposits and $1.7 billion in assets in current dollars), in response to concerns that its increased size would be potentially anticompetitive.[6] A new bank holding company, Independent Bancorp of Arizona, was created to buy the branches. The purchase, however, did not take place until a year later, in April 1993, because Independent had difficulty raising the required capital. As of this date, Independent was

[5]The size of Citicorp's acquisition in real 1986 dollars was approximately $806 million, which is the size of a smaller bank. Its assets did not increase to more than $1 billion until 1988 when it purchased United Bank of Arizona. We, therefore, placed it in the smaller bank category for the years 1986 through 1987.

[6]These concerns were similar to those of regulators in Washington state discussed in appendix III.

Arizona's fifth largest bank company—the only large in-state bank—and was operating its banks under the name Caliber Bank.

As a result of the divestiture, Bank of America Arizona became the state's second largest bank with approximately $10 billion in assets and 28 percent in market share.

As had been the case in Washington, at the time of our review there had not been a study on whether competition within the state had declined because of the merger, according to federal regulators. However, one regulator expressed hope that the newly formed bank would be a viable competitor to Bank of America Arizona.

Interstate Banking Has Changed Ownership of Smaller Banks but Not Caused Their Demise

Although they are expected to continue to fill a niche in the Arizona banking industry, smaller banks played less of a role during the late 1980s and early 1990s than they had in earlier years. As in California, their numbers fluctuated greatly with the state's economic changes. When the economy was strong in the early to middle 1980s, many new smaller banks were formed. After the economic collapse, several smaller banks failed and were mostly bought by out-of-state bank holding companies. Few new smaller banks have taken their place, a fact that regulators and bankers attributed to a lack of capital, not interstate banking.

Consolidation and Acquisitions of Smaller Banks

Smaller banks increased in number from 42 in 1984 to a peak of 50 in 1986, and then declined to 32 in mid-1993. Acquisitions occurred in all years, and in most were partially offset by new bank entry. New bank formation was particularly strong in the mid-1980s when the economy was still strong. From 1985 through 1987, 12 new banks were formed, in contrast with only 4 between 1988 and 1992. All new smaller bank charters were for in-state banks, because de novo entry was prohibited for interstate banks until mid-1992. Capital availability, not a saturated banking market, was the primary reason for the decline in the creation of new smaller banks, according to a state banking regulator.

Table IV.3 shows the number of in-state and out-of-state acquisitions of smaller banks from 1986 through 1992. Some of these acquisitions resulted in a change of ownership from in-state to out-of-state, while others resulted in the disappearance of a bank, because the acquirer was already present in the Arizona market. Twenty-nine of the 39 acquisitions were in-state smaller banks purchased by out-of-state holding companies. Many were single smaller banks that continued to be operated as single entities after the acquisitions.

Table IV.3: Consolidation of Smaller Banks

	Out-of-state acquisitions of smaller banks		In-state acquisitions of smaller banks		Total acquisitions of smaller banks	
Year	**Solvent**	**Failed**	**Solvent**	**Failed**	**Solvent**	**Failed**
1986-88	16	1	4	1	20	2
1989-92	4	8	0	5	4	13
Total	**20**	**9**	**4**	**6**	**24**	**15**

Source: FDIC call report data.

Table IV.3 also shows that the greatest number of acquisitions occurred from 1986 through 1988, almost all of which were of solvent institutions. From 1989 through 1992, the frequency of acquisitions declined somewhat and most were of failed institutions.

Table IV.4 shows the market share trends for interstate and in-state smaller banks. Between 1985 and 1990, in-state smaller banks steadily lost market share, with their greatest losses occurring in 1986, when the economy was still healthy and interstate banking first passed. Interstate smaller banks, on the other hand, gained in market share until 1989 and then declined as the economy faltered. Nevertheless, throughout the middle to late 1980s, interstate smaller banks held a larger share of the market than did in-state smaller banks. It was not until 1991, when in-state smaller banks began to increase in market share (partly through the creation of three new banks) and interstate banks continued to decrease, that this trend was reversed.

Table IV.4: Market Share Comparison of Out-of-State and In-State Smaller Banks

Year	Market share of out-of-state smaller banks	Market share of in-state smaller banks	Market share of all smaller banks
1985	0.0%	11.2%	11.2%
1986	6.9	6.6	13.5
1987	9.0[a]	5.6	14.6
1988	5.9	5.5	11.4
1989	6.7	4.8	11.5
1990	6.5	3.2	9.7
1991	5.5	4.4	9.9
1992	4.6	6.3	10.9
1993[b]	4.8	6.8	11.6

[a]Includes the only foreign bank in Arizona from 1987 through 1993. It was a smaller bank and in 1993 had .2 percent share of the market.

[b]1993 data are as of June 30. All other data are as of December 31.

Source: FDIC call report data.

While smaller banks as a group were recapturing market share, a divergent trend was occurring within the group. For example, the market share held by banks with less than $100 million in assets declined from 3.8 percent to 2.7 percent, while the market share for banks with assets from $100 million to $1 billion increased from 7.1 percent to 8.8 percent.

Interstate Banking and Small Business Lending in Arizona

Our discussions in selected local markets with regulators, focus group participants, and bankers in Arizona revealed that, as in California and Washington, some small businesses have had difficulty obtaining loans. However, as before, we were unable to determine whether this was a direct result of interstate banking, because other factors (i.e., poor economic conditions and changes in bank regulation) were seen as playing a role.

Data on Small Business Lending Is Incomplete

Similar to our review of the other two states, we began by using the most complete data on bank lending (i.e., call reports and SBA data) to assess the total amount of commercial lending to businesses and the amount of one type of small business lending.[7]

[7]For a discussion of the data limitations, see appendix II.

As mentioned previously, in Arizona, out-of-state bank holding companies owned banks of all sizes. Therefore, we looked at lending patterns by both bank size and ownership to determine whether significant differences existed between (1) large and smaller banks and (2) out-of-state banks and in-state banks. We found that Arizona banks did not completely follow the trend in Washington, where large banks invested a higher percentage of their assets in loans than did smaller banks.

Figure IV.1 shows that in Arizona smaller banks normally provided higher percentages of loans to assets prior to the state's economic downturn in 1988. Although, after the effects of the downturn were felt and both large and smaller banks decreased their total lending, large banks tended to provide higher percentages of loans to assets than did smaller banks.

Figure IV.1: Lending in Arizona

Source: FDIC call report data.

Our analysis of the quarterly June 1993 call report data on small business lending showed that large banks invested a greater dollar amount than did smaller banks to small business lending (i.e., C&I and commercial real estate) during the 3 months, but that smaller banks devoted a greater portion of their assets to this type of lending than did larger banks. Large banks had $2.1 million invested in small business loans, or 6.7 percent of their assets. Smaller banks, on the other hand, had invested nearly $500,000 in these types of loans, or 10.8 percent of their assets. Moreover, this relationship did not change when C&I and commercial real estate loans were analyzed separately.

Table IV.5 compares the loan portfolios of Arizona's in-state and out-of-state banks of various sizes. Significant observations include the following:

- Among large banks, those owned out-of-state invested a larger portion of their assets in loans than those owned in-state.[8] However, among smaller banks, those owned in-state tended to provide more loans.
- In each size category, in-state banks provided proportionately more commercial loans overall than did their out-of-state counterparts.[9]
- In regard to the types of commercial lending, in-state banks tended to make more commercial real estate loans and either more or about the same amount of C&I loans as out-of-state banks.

[8]From 1984 through 1985, there was only one out-of-state large bank. From 1988 through 1992, there was only one in-state large bank.

[9]Although not shown in table IV.5, the commercial loans-to-assets ratio of all the bank categories declined over time and that of out-of-state banks showed the greater decrease.

Table IV.5: Loan Portfolio Comparison as a Percentage of Assets

1984-92 average percentage

Bank type	Loans/assets	Commercial loans/assets	Commercial real estate loans/assets	C&I loans/assets
Large banks				
Out-of-state	66.2%[a]	26.3%	11.9%	14.4%
In-state	64.6	29.3	14.6	14.7
Smaller banks: assets from $100 million to $1 billion				
Out-of-state	69.6	28.3	15.8	12.5
In-state	70.6	38.0	14.7	23.3
Smaller banks: assets less than $100 million				
Out-of-state	58.5	33.8	11.8	21.9
In-state	61.5	36.8	15.1	21.7

Note: In-state bank averages were calculated as the average of the weighted annual means for each category from 1984 through 1992. The average for out-of-state banks was calculated from 1986 through 1992 because interstate banking legislation was not passed until 1986.

[a]From 1991 through 1992, the percentage of assets large out-of-state banks invested in total loans dropped from 66.3 percent to 48.5 percent. If 1992 were excluded from the average, this average would rise to 68.4 percent from 1984 through 1991.

Source: FDIC call report data.

As for SBA-guaranteed loans, nonbanks had a greater role in Arizona than they did in Washington and California (see table IV.6). They were the strongest providers, followed very closely by smaller banks. As in California, large banks accounted for a relatively low percentage of total SBA loans. The top five individual lenders included two nonbanks and three smaller banks.

Table IV.6: SBA Lending by Type of Institution in Arizona, 1988-1992

Type of institution	Number of loans	Percent of total
Nonbanks	440	44.9
Smaller banks	435	44.3
Large banks	100	10.2
Thrifts and saving banks	6	0.6

Source: SBA data.

Trend Toward Centralized and Standardized Loan Practices

Centralized and standardized loan processes used by the two large interstate banks and one large in-state bank we visited in Arizona worked similarly to processes used in California and Washington. That is, small business loan decisions were made primarily by comparing the loan application to standardized loan criteria. The smaller small business loan applications were usually handled in loan processing centers, while applications for larger loans were usually handled by loan officers spread across the state.

Many interstate bankers we spoke with believed that centralization and standardization had increased, not decreased, credit access for small businesses because large banks could now make a vast number of small business loans in a cost-effective manner. Moreover, two officials mentioned that personnel at centralized locations specialized geographically and supplemented their expertise through contact with branch personnel.

As in Washington, Arizona interstate bankers mentioned that the broad credit policies that governed their overall lending strategies were developed by their corporate managers out-of-state and applied to all lending centers. Examples of corporate policies included (1) categories of riskiness for various types of lending or industries and (2) procedures and approval levels for loans of various types or amounts. Industries and types of lending characterized as “high risk” included commercial real estate related lending, restaurants, and high-technology companies. Interstate bankers noted that they might influence these broad guidelines, but typically, the only state-to-state variations taken into account were differences in laws and regulations.

Centralization and Standardization May Affect Credit Availability

To enhance our understanding of credit availability concerns in Arizona, we focused on three markets to see if we could ascertain whether small businesses were having difficulty obtaining loans and what role, if any, interstate banking and industry consolidation played.[10] We (1) held focus group discussions in each market with individuals who worked closely with small businesses on financing issues, (2) interviewed regulators, and (3) interviewed officials from interstate and smaller banks who were major providers of small business loans.

The overall perceptions expressed in the Arizona focus groups and among some bankers and government officials were similar to those expressed in

[10]The markets were Phoenix, Tucson, and Yuma. Appendix I briefly describes these locations.

California and Washington. That is, some small businesses that were once able to get loans can no longer do so.

Arizona focus groups strongly believed that remote decisionmaking—whether in evaluating individual loans at centralized locations or in setting broad credit policies at a corporate level—led banks to refuse some loans. Each group explained in detail how centralization and standardization impeded loans to small businesses.

One focus group participant, a senior credit officer at a major loan fund, described a successful general contractor based in Sierra Vista, a rural town about 60 miles south of Tucson. This contractor needed a $300,000 loan to buy the building and the attached land that he rented for the company's Tucson projects. The credit officer evaluated the loan, found it to be a solid, creditworthy deal, and committed his fund to financing one-half of the amount. However, he was unable to obtain funding of the remaining half from one of the large banks whose branches were the only banks in Sierra Vista. For several reasons, the contractor found it impractical to use a bank outside of Sierra Vista, thus, he had no financial alternatives to the large banks. According to the credit officer, a local loan officer of one of the large banks agreed that the loan was creditworthy but was unable to convince the bank's officials in Phoenix to approve the loan.

The credit officer blamed centralized decisionmaking processes for preventing the large banks from funding the loan. Corporate-level polices requiring additional layers of review and documentation for construction-related loans, he believed, led subsidiaries in Arizona to turn down most construction loans, even when they were, in his view, creditworthy.

A second experience was related by the executive director of a loan fund to illustrate that the borrower's character and community commitment was not always taken into account by large banks. A well-established Tucson construction company, which had been profitable during the 1980s, suffered a 1-year significant loss in the early 1990s. Over the objections of local loan officers at the bank where this company had long been a customer, the bank's final decisionmakers in Phoenix decided not to renew the company's $200,000 line of credit. The local loan officers felt that, given the long-term relationship, the character of the borrower, and the fact that the company was a major employer in the community, the credit line should have been extended. The Phoenix officials, however, based their decision on the fact that the company was in a high-risk industry and had suffered a serious loss. The loan fund director, who provided a loan so that the company could pay off the large bank and make necessary changes to return to profitability, viewed this case as an example of how remote decisionmaking could lead large banks to abandon long-term customers facing temporary financial problems.

Several interstate bankers also shared the perspective that, in some respects, centralization and standardization had made it more difficult for some small businesses to obtain credit. Two noted the necessity of having lending officers in local areas because personnel housed at centralized locations did not always understand the unique features of a local market. A third mentioned that standardization and centralization could impair credit access because some small businesses did not maintain the type of documentation centralized and standardized systems required to make loan decisions.

Participants did not, however, perceive large banks as uniformly unresponsive to small business needs. On the basis of their experiences with individual banks, they saw some as better than others. The overriding determinant, according to not only focus group participants but several bankers as well, is a bank's management philosophy and the degree to which it maintains a local market presence.

Further, several bankers we spoke with from Arizona's interstate banks echoed the perspective of large bankers in the other two states that centralization and standardization had allowed banks with extensive branch networks to become more active in the small business market because it lowered their internal cost of providing small business loans. Focus group participants, however, tended to work with small businesses that were, in their view, creditworthy but did not easily fit standardized criteria or policies found in a centralized and standardized system.

The types of small businesses seen as susceptible to credit availability problems were similar to those described in California and Washington. These included businesses that

- needed loans for less than $100,000,
- could not easily be evaluated according to standardized criteria, or
- were in industries that were classified as "high risk."

Industry Consolidation May Have Varying Effects on Credit Availability

Industry consolidation within Arizona occurred both through the acquisition of solvent financial institutions and through the disappearance or acquisition of failed financial institutions. Between 1986 and 1992, the majority of the acquisitions were by out-of-state bank holding companies.

Because out-of-state bank holding companies have purchased so many banks and thrifts, several focus group participants and bankers noted that interstate banking increased the availability of capital to the extent of saving the banking industry after the economy faltered. In regard to small business lending, however, many focus group participants felt that out-of-state banks had centralized their operations to such an extent that they lost touch with the community and that this had made small business credit more difficult in some areas. Acquisition-related reasons cited for credit difficulty included (1) temporary inefficiencies during the transition in management, (2) a decrease in the number of banks in local communities, and (3) changes in the newly formed bank's lending philosophy.

A focus group participant involved in attracting new businesses to Arizona explained how transitional inefficiencies can make it more time consuming for small businesses to obtain credit. He believed that these types of difficulties could temporarily hinder the economic growth of a market. For example, a California-based company that manufactured and refurbished railroad cars needed a $700,000 loan to expand into Arizona. An Arizona bank approved the loan but was bought by another bank before the loan could be made. The acquiring bank, which had just centralized its approval process, required the company to submit a new application to the loan-making center because the loan pertained to a high-risk lending area. The company, feeling that it had already spent more than enough time trying to get a loan from the first bank, went instead to a smaller bank in the area.

A second merger-related cause of small business credit difficulty mentioned in some markets was a reduction in competition that could occur when an out-of-state bank already in an area acquires another bank in the same area. This scenario is more likely to occur after a state has permitted interstate banking for several years, when out-of-state banks have already entered a state and are looking to expand their market share in communities in which they are already located.

A well-known example of the loss of a competitor is the merger between BankAmerica Corporation and Security Pacific Corporation in 1992, because both had bank branches located in many of the same markets across the state. Apart from this merger, in 4 of the state's 15 counties between 1985 and 1990, large out-of-state banks absorbed smaller banks that had not been replaced by new local banks as of year-end 1992.

A third case in which mergers can impair small business credit in local markets is when a bank that de-emphasizes small business lending takes over a local bank that has been an active small business lender. Unfortunately, we were unable to determine whether out-of-state banks altered the lending strategies of the banks they took over in particular local markets or in regard specifically to small business lending, because data were unavailable. However, we were able to determine whether these banks altered the total amount of lending or the overall lending strategy statewide upon entering the state by comparing loan portfolios before and after acquisitions. We limited this analysis to the three largest interstate banks—Security Pacific Bank Arizona, Citibank Arizona, and Chase Bank of Arizona—that bought institutions between 1986 and 1988 so we could compare acquiring banks with sound acquired banks.

Table IV.7 shows that Security Pacific Bank Arizona and Chase Bank of Arizona made more total loans on average than did the banks their holding companies took over, but that Citibank Arizona made somewhat less. Security Pacific Bank Arizona increased its total lending by increasing all three types of loans: consumer, commercial real estate, and C&I loans. Security Pacific Bank Arizona was also the only one of the three banks that undertook more total commercial lending than consumer lending. Chase Bank of Arizona, on the other hand, increased total lending by increasing its consumer lending and made fewer commercial loans than the bank it acquired. Finally, Citibank Arizona made fewer loans than the banks it acquired, and like Chase Bank Arizona, emphasized consumer over commercial lending. The strategy of these two banks began before the recession in Arizona eliminated many of the commercial lending opportunities.

Table IV.7: Comparison of Average Lending Patterns of Out-of-State Banks With Their Acquired Banks

Constant 1992 dollars in thousands

Acquired bank / New subsidiary	Total loans[a]	Total consumer loans	Commercial lending: Total commercial loans	C&I loans	Commercial real estate loans
Arizona Bank	$3,353	$1,348	$1,623	$723	$900
Security Pacific Bank Arizona[b]	**4,940**	**1,621**	**2,097**	**865**	**1,233**
Continental Bank	499	101	383	115	268
Chase Bank of Arizona	**632**	**400**	**219**	**64**	**155**
Great Western Bank and United Bank	2,247	534	1,488	822	666
Citibank Arizona[c]	**1,917**	**912**	**796**	**266**	**530**

Note: The table compares the yearly average of the loans made during 1984 through 1985 by the banks acquired by the holding companies of Security Pacific Bank Arizona, Chase Bank of Arizona, and Citibank Arizona when they entered Arizona with the yearly average loans made by Security Pacific Bank Arizona from 1987 to 1991 (the year before its merger with Bank of America), by Chase Bank of Arizona from 1987 to 1992, and by Citibank Arizona from 1988 (the year it acquired United Bank) to 1992. The table does not include First Interstate Bank Arizona, because it was already operating in Arizona in 1984, or Bank of America Arizona, because it entered the state in 1990 when its holding company acquired failed thrifts.

[a]Total lending includes other types of loans besides consumer and commercial; therefore, it does not equal total consumer lending plus total commercial lending.

[b]Security Pacific Corporation also purchased two smaller banks in 1989 and 1990 with total loans of $21.1 million and two thrifts in 1991 with total assets of $1,544.3 million (loan data were not available).

[c]Citicorp also purchased four smaller banks between 1989 and 1990 with loans totaling $60.2 million.

Source: FDIC call report data.

Credit Seen as Tight in Markets That Reportedly Lacked Sufficient Alternatives to Large Banks

As in California and Washington, standardization, centralization, and consolidation were seen as causing problems for small business credit availability, particularly where it was believed that there were insufficient alternatives to large banks. Some focus group participants and some bankers thought that smaller banks, often seen as one of the most crucial providers of small business loans, were insufficiently spread throughout the state. Also, the total number of smaller banks had diminished by 36 percent from 1986 through mid-1993, and those that remained reportedly had small capital bases.

Rural areas were often highlighted as experiencing the most severe credit problems. In contrast, one area in the state specifically mentioned by several participants as having little unmet demand was Tucson.

Focus group participants contended that rural areas in particular lacked sufficient numbers of smaller banks. Our review of local market deposit data showed that as of June 1992, 3 of 12 rural counties lacked a smaller bank, while in 6 more counties, smaller banks held less than 5 percent of the deposits.

Problems associated with centralized and standardized practices of large banks are exacerbated in rural areas that must rely on these banks for the bulk of small business credit, according to focus group participants and others we spoke with. They cited two reasons: (1) decisionmaking can be further removed from rural than urban areas and (2) the criteria and policies and procedures used to evaluate loans may not take into account the unique nature of rural businesses.

In Tucson, credit availability might have been seen as sufficient because the city had a strong economic development infrastructure and well-established loan funds. Tucson focus group participants mentioned, for example, that Tucson had more financing alternatives for small businesses than did other markets in Arizona, including Phoenix, which is larger. According to one participant, these alternatives developed because Tucson had an aggressive economic development department that had, as far back as the late 1970s, recognized that small businesses were having difficulty obtaining credit.

Comments From FDIC

FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429

Office of Executive Director
Supervision and Resolutions

June 3, 1994

Mr. James L. Bothwell
Director, Financial Institutions
and Market Issues
General Accounting Office
Washington, D.C. 20548

Dear Mr. Bothwell:

Acting Chairman Hove requested I respond to your letter of May 12, 1994 asking for comment on a draft report entitled, Interstate Banking: Consolidation and Small Business Lending in Three Western States.

The report focuses on California, Washington and Arizona, and the changes that occurred in each state's banking environment over the December 1984 through June 1993 period. The report evaluates whether the geographic banking laws in these three states had any effect on (1) the market share and number of large banks, (2) whether smaller banks remained viable, and (3) the availability of credit to small businesses.

Smaller banks are defined in the report as those with total assets of $1 billion of less. This definition may be too broad. Enclosed are four schedules (see tables A-1 through A-4) that analyze the changes in the number and total assets of FDIC-insured commercial banks from 1984 through 1993. A schedule was prepared for each of the three states and for all FDIC-insured commercial banks. Six size categories were identified and banks in the 50 largest holding companies were listed separately in each of these categories. The holding company data is in recognition of the fact that your report cited that smaller institutions, when acquired by a large holding company, are reported to often experience a change in loan policies and removal of decision-making authority from the local level.

See pp. 6 and 13.

A review of this data discloses two diverging trends. In all three states commercial banks under $100 million in size experienced a decline in number of institutions and, in two states, a decline in total assets. During this same period, while the largest banks may have held their own, commercial banks between $100 million and $1 billion in total assets experienced an increase in both number and total assets. Since the number of banks in the under $100 million size category is significant in each of the three states, it appears that a break out in your report of the smaller bank category might be appropriate in order to identify these two trends. In any case, we concur in the finding that smaller banks can be and in fact are profitable and viable, even in the face of giant competitors.

Secondly, on the matter of credit availability, the report indicates that focus group participants and some bankers opined that standardization of loan criteria and removal of loan decisions from local bank officers knowledgeable about the community happened when small banks were absorbed by big ones and this resulted in impaired access to credit for small businesses. As a result, you suggest that small businesses may have more difficulty obtaining credit as nationwide banking and branching becomes more common.

The statistics, however, indicate that this may not be the case for a number of reasons. For example, June 1993 Call Report data for all FDIC-insured commercial banks (see table B-2, Percentages) indicate that a majority of all small domestic C & I loans (loans with original amounts of $1 million or less) and over three quarters of all domestic C & I loans are made by larger institutions (banks over $1 billion in total assets). These trends are similar for each of the three states (see tables B-3 through B-8). We note that the larger banks' proportion of small business loans to total assets is less than for the medium size groups, but the dollar volumes are still impressive.

Moreover, all insured institutions have a statutory responsibility to meet the legitimate credit needs of their communities and the federal regulatory agencies have a responsibility to assure that bank policies are aimed at meeting those legitimate credit needs. The Community Reinvestment Act and section 6 of the Federal Deposit Insurance Act specifically address this topic.

Over the past two years the FDIC and the other federal regulators have taken a number of steps to improve the availability of credit to businesses and individuals. These initiatives have included changes to regulatory reporting requirements as well as changes to supervisory policies. We expect that as credit availability issues are identified, either on a global or institution-specific basis, the agencies will continue to address this important area.

See p. 14.

Finally, it is recommended that the report acknowledge that other factors such as the overall health of banks in a geographic area, local business conditions, other non-bank competitors and the trends in the securitization of loans also will have an impact on the availability of credit to small businesses and other borrowers.

We appreciate the opportunity to review the draft report.

Sincerely,

John W. Stone

John W. Stone
Executive Director

Enclosures

Classifications of FDIC-Insured Commercial Banks, 12/31/84 and 12/31/93
Sources: Call Report and Structure Data on RIS; Holding Company ID's on NIC
Prepared 05/25/94 by FDIC Division of Research and Statistics (WSK)

A-1

Notes:
Dollar amounts are in millions.
Holding Company relationship is to "Financial High Holder."
Holding Company sizes are total FDIC-insured commercial bank subsidiary asset totals.
Asset amounts are as reported; 1984 amounts have not been adjusted for inflation.

	12/31/93				12/31/84			
	Number	% of Total	Assets	% of Total	Number	% of Total	Assets	% of Total
All FDIC-insured Commercial Banks	10,958		3,705,947		14,483		2,508,871	
Under $100 million	7,788	71.1	334,976	9.0	12,044	83.2	404,223	16.1
No HC or not in top 50	7,676	70.0	328,445	8.9	11,651	80.4	385,249	15.4
HC in top 50	112	1.0	6,531	0.2	393	2.7	18,974	0.8
$100-250 million	1,957	17.9	298,602	8.1	1,543	10.7	231,086	9.2
No HC or not in top 50	1,810	16.5	274,010	7.4	1,328	9.2	197,751	7.9
HC in top 50	147	1.3	24,591	0.7	215	1.5	33,335	1.3
$250-500 million	587	5.4	204,516	5.5	412	2.8	139,930	5.6
No HC or not in top 50	484	4.4	168,178	4.5	333	2.3	112,827	4.5
HC in top 50	103	0.9	36,338	1.0	79	0.5	27,103	1.1
$500m - $1 billion	244	2.2	173,902	4.7	206	1.4	142,896	5.7
No HC or not in top 50	176	1.6	123,791	3.3	166	1.1	114,487	4.6
HC in top 50	68	0.6	50,111	1.4	40	0.3	28,408	1.1
$1 to $10 billion	327	3.0	1,063,485	28.7	254	1.8	725,947	28.9
No HC or not in top 50	169	1.5	494,410	13.3	185	1.3	435,112	17.3
HC in top 50	158	1.4	569,075	15.4	69	0.5	290,835	11.6
$10 billion or more	55	0.5	1,630,465	44.0	24	0.2	864,789	34.5
No HC or not in top 50	3	0.0	32,403	0.9	0	0.0	0	0.0
HC in top 50	52	0.5	1,598,063	43.1	24	0.2	864,789	34.5
Total:								
No HC or not in top 50	10,318	94.2	1,421,237	38.4	13,663	94.3	1,245,426	49.6
HC in top 50	640	5.8	2,284,709	61.6	820	5.7	1,263,444	50.4

Classifications of FDIC-Insured Commercial Banks in Arizona, 12/31/93 and 12/31/84
Sources: Call Report and Structure Data on RIS; Holding Company ID's on NIC
Prepared 05/25/94 by FDIC Division of Research and Statistics (WSK)

A-2

Notes:
Dollar amounts are in millions.
Holding Company relationship is to "Financial High Holder."
Holding Company sizes are total FDIC-insured commercial bank subsidiary asset totals.
Asset amounts are as reported; 1984 amounts have not been adjusted for inflation.

	12/31/93				12/31/84			
	Number	% of Total	Assets	% of Total	Number	% of Total	Assets	% of Total
All FDIC-insured Commercial Banks	37		37,105		46		21,475	
Under $100 million	21	56.8	994	2.7	37	80.4	823	3.8
No HC or not in top 50	19	51.4	811	2.2	37	80.4	823	3.8
HC in top 50	2	5.4	183	0.5	0	0.0	0	0.0
$100-250 million	5	13.5	667	1.8	3	6.5	510	2.4
No HC or not in top 50	4	10.8	451	1.2	3	6.5	510	2.4
HC in top 50	1	2.7	215	0.6	0	0.0	0	0.0
$250-500 million	3	8.1	1,093	2.9	1	2.2	425	2.0
No HC or not in top 50	3	8.1	1,093	2.9	1	2.2	425	2.0
HC in top 50	0	0.0	0	0.0	0	0.0	0	0.0
$500m - $1 billion	1	2.7	527	1.4	1	2.2	583	2.7
No HC or not in top 50	0	0.0	0	0.0	1	2.2	583	2.7
HC in top 50	1	2.7	527	1.4	0	0.0	0	0.0
$1 to $10 billion	6	16.2	22,646	61.0	4	8.7	19,133	89.1
No HC or not in top 50	2	5.4	3,022	8.1	2	4.3	4,898	22.8
HC in top 50	4	10.8	19,624	52.9	2	4.3	14,236	66.3
$10 billion or more	1	2.7	11,178	30.1	0	0.0	0	0.0
No HC or not in top 50	0	0.0	0	0.0	0	0.0	0	0.0
HC in top 50	1	2.7	11,178	30.1	0	0.0	0	0.0
Total:								
No HC or not in top 50	28	75.7	5,377	14.5	44	95.7	7,239	33.7
HC in top 50	9	24.3	31,727	85.5	2	4.3	14,236	66.3

Classifications of FDIC-Insured Commercial Banks in California, 12/31/93 and 12/31/84
Sources: Call Report and Structure Data on RIS; Holding Company ID's on NIC
Prepared 05/25/94 by FDIC Division of Research and Statistics (WSK)

A-3

Notes:
Dollar amounts are in millions.
Holding Company relationship is to "Financial High Holder."
Holding Company sizes are total FDIC-insured commercial bank subsidiary asset totals.
Asset amounts are as reported; 1984 amounts have not been adjusted for inflation.

	12/31/93				12/31/84			
	Number	% of Total	Assets	% of Total	Number	% of Total	Assets	% of Total
All FDIC-insured Commercial Banks	425		328,527		452		279,211	
Under $100 million	228	53.6	11,882	3.6	346	76.5	13,254	4.7
No HC or not in top 50	224	52.7	11,824	3.6	342	75.7	13,130	4.7
HC in top 50	4	0.9	58	0.0	4	0.9	124	0.0
$100-250 million	118	27.8	18,494	5.6	60	13.3	9,143	3.3
No HC or not in top 50	114	26.8	17,826	5.4	60	13.3	9,143	3.3
HC in top 50	4	0.9	668	0.2	0	0.0	0	0.0
$250-500 million	37	8.7	12,996	4.0	20	4.4	7,110	2.5
No HC or not in top 50	37	8.7	12,996	4.0	19	4.2	6,854	2.5
HC in top 50	0	0.0	0	0.0	1	0.2	256	0.1
$500m - $1 billion	22	5.2	16,578	5.0	9	2.0	6,852	2.5
No HC or not in top 50	21	4.9	15,598	4.7	9	2.0	6,852	2.5
HC in top 50	1	0.2	980	0.3	0	0.0	0	0.0
$1 to $10 billion	16	3.8	43,919	13.4	12	2.7	32,551	11.7
No HC or not in top 50	15	3.5	41,970	12.8	10	2.2	19,241	6.9
HC in top 50	1	0.2	1,949	0.6	2	0.4	13,310	4.8
$10 billion or more	4	0.9	224,658	68.4	5	1.1	210,301	75.3
No HC or not in top 50	0	0.0	0	0.0	0	0.0	0	0.0
HC in top 50	4	0.9	224,658	68.4	5	1.1	210,301	75.3
Total:								
No HC or not in top 50	411	96.7	100,214	30.5	440	97.3	55,220	19.8
HC in top 50	14	3.3	228,313	69.5	12	2.7	223,991	80.2

Classifications of FDIC-Insured Commercial Banks in Washington, 12/31/93 and 12/31/84
Sources: Call Report and Structure Data on RIS; Holding Company ID's on NIC
Prepared 05/25/94 by FDIC Division of Research and Statistics (WSK)

A-4

Notes:
Dollar amounts are in millions.
Holding Company relationship is to "Financial High Holder."
Holding Company sizes are total FDIC-insured commercial bank subsidiary asset totals.
Asset amounts are as reported; 1984 amounts have not been adjusted for inflation.

	12/31/93				12/31/84			
	Number	% of Total	Assets	% of Total	Number	% of Total	Assets	% of Total
All FDIC-insured Commercial Banks	87		41,435		102		29,025	
Under $100 million	61	70.1	2,586	6.2	87	85.3	2,856	9.8
No HC or not in top 50	59	67.8	2,525	6.1	86	84.3	2,849	9.8
HC in top 50	2	2.3	61	0.1	1	1.0	7	0.0
$100-250 million	13	14.9	1,789	4.3	5	4.9	640	2.2
No HC or not in top 50	13	14.9	1,789	4.3	5	4.9	640	2.2
HC in top 50	0	0.0	0	0.0	0	0.0	0	0.0
$250-500 million	6	6.9	1,897	4.6	3	2.9	1,108	3.8
No HC or not in top 50	6	6.9	1,897	4.6	3	2.9	1,108	3.8
HC in top 50	0	0.0	0	0.0	0	0.0	0	0.0
$500m - $1 billion	2	2.3	1,374	3.3	1	1.0	660	2.3
No HC or not in top 50	2	2.3	1,374	3.3	1	1.0	660	2.3
HC in top 50	0	0.0	0	0.0	0	0.0	0	0.0
$1 to $10 billion	4	4.6	18,706	45.1	6	5.9	23,761	81.9
No HC or not in top 50	1	1.1	1,938	4.7	3	2.9	4,975	17.1
HC in top 50	3	3.4	16,767	40.5	3	2.9	18,785	64.7
$10 billion or more	1	1.1	15,084	36.4	0	0.0	0	0.0
No HC or not in top 50	0	0.0	0	0.0	0	0.0	0	0.0
HC in top 50	1	1.1	15,084	36.4	0	0.0	0	0.0
Total:								
No HC or not in top 50	81	93.1	9,523	23.0	98	96.1	10,232	35.3
HC in top 50	6	6.9	31,912	77.0	4	3.9	18,792	64.7

ALL FDIC-INSURED COMMERCIAL BANKS NUMBER OF SMALL BUSINESS C&I LOANS
AS OF JUNE 30, 1993
ACTUAL NUMBER OF LOANS

B-1

	Number of Loans			
Bank Asset Size	Under $100,000	$100,000 to $250,000	$250,000 to $1,000,000	Number of All Small Domestic C&I Loans
<100 Million	333,582	29,542	14,218	377,342
$100 - $250 Million	341,849	36,483	22,301	400,633
$250 - $500 Million	210,388	24,211	17,467	252,066
$500 Million - $ 1 Billion	195,344	22,753	19,384	237,481
$1 Billion - $10 Billion	998,281	86,874	74,053	1,159,208
>$10 Billion	439,149	53,498	52,453	545,100
All	2,518,593	253,361	199,876	2,971,830

PERCENTAGES

Bank Asset Size	% Under $100,000	% of $100,000 to $250,000	% of $250,000 to $1,000,000	% of All Small C&I Loans
<100 Million	13.2%	11.7%	7.1%	12.7%
$100 - $250 Million	13.6%	14.4%	11.2%	13.5%
$250 - $500 Million	8.4%	9.6%	8.7%	8.5%
$500 Million - $ 1 Billion	7.8%	9.0%	9.7%	8.0%
$1 Billion - $10 Billion	39.6%	34.3%	37.0%	39.0%
>$10 Billion	17.4%	21.1%	26.2%	18.3%
All	100.0%	100.0%	100.0%	100.0%

PREPARED BY: THE FDIC DIVISION OF RESEARCH & STATISTICS
SOURCE: BANK CALL REPORTS
M N.J May 26, 1994

B-2

ALL FDIC–INSURED COMMERCIAL BANKS SMALL BUSINESS C&I LOANS**
AS OF JUNE 30, 1993
(Amounts in $ Millions)
ORIGINAL LOAN AMOUNT

Bank Asset Size	Original Loan Amount: Under $100,000	$100,000 to $250,000	$250,000 to $1,000,000	All Small Domestic C&I Loans	Total Domestic C&I Loans	As a % of All C&I Loans	Gross Domestic Loans	All Small C&I Loans As a % of Gross Domestic Loans	Total Assets	All Small Domestic C&I Loans As a % of Total Assets
<100 Million	5,541	3,194	3,744	12,479	29,645	42.1%	180,783	6.9%	340,704	3.7%
$100 – $250 Million	6,046	3,832	6,361	16,239	29,012	56.0%	163,122	10.0%	291,962	5.6%
$250 – $500 Million	4,036	2,618	5,245	11,899	21,176	56.2%	116,909	10.2%	198,693	6.0%
$500 Million – $1 Billion	3,484	2,442	5,146	11,072	21,116	52.4%	105,529	10.5%	176,498	6.3%
$1 – $10 Billion	14,362	8,927	21,082	44,371	138,477	32.0%	611,544	7.3%	1,010,710	4.4%
>$10 Billion	8,813	5,391	14,381	28,585	200,315	14.3%	687,655	4.2%	1,550,767	1.8%
All	42,282	26,404	55,959	124,645	439,741	28.3%	1,865,542	6.7%	3,569,334	3.5%

PERCENTAGES

Bank Asset Size	% Under $100,000	% of $100,000 to $250,000	% of $250,000 to $1,000,000	% of All Small C&I Loans	% of Total C&I Loans	% of Gross Loans	% of Total Assets
<100 Million	13.1%	12.1%	6.7%	10.0%	6.7%	9.7%	9.5%
$100 – $250 Million	14.3%	14.5%	11.4%	13.0%	6.6%	8.7%	8.2%
$250 – $500 Million	9.5%	9.9%	9.4%	9.5%	4.8%	6.3%	5.6%
$500 Million – $1 Billion	8.2%	9.2%	9.2%	8.9%	4.8%	5.7%	4.9%
$1 – $10 Billion	34.0%	33.8%	37.7%	35.6%	31.5%	32.8%	28.3%
>$10 Billion	20.8%	20.4%	25.7%	22.9%	45.6%	36.9%	43.4%
All	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

**Represents commercial & industrial loans in domestic offices.

Domestic commercial & industrial loans are only for domestic offices.

Gross loans are before reserves and include unearned income.

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SOURCE: BANK CALL REPORTS
M.N.J May 26, 1994

ALL FDIC–INSURED COMMERCIAL BANKS NUMBER OF SMALL BUSINESS C&I LOANS
ARIZONA
AS OF JUNE 30, 1993
ACTUAL NUMBER OF LOANS

B-3

Bank Asset Size	Number of Loans: Under $100,000	Number of Loans: $100,000 to $250,000	Number of Loans: $250,000 to $1,000,000	Number of All Small Domestic C&I Loans
<100 Million	1,148	164	90	1,402
$100 – $250 Million	2,541	219	150	2,910
$250 – $500 Million	1,907	396	226	2,529
$500 Million – $1 Billion	256	3	6	265
$1 – $10 Billion	3,958	515	470	4,943
>$10 Billion	0	0	0	0
All	9,810	1,297	942	12,049

PERCENTAGES

Bank Asset Size	% Under $100,000	% of $100,000 to $250,000	% of $250,000 to $1,000,000	% of All Small C&I Loans
<100 Million	11.7%	12.6%	9.6%	11.6%
$100 – $250 Million	25.9%	16.9%	15.9%	24.2%
$250 – $500 Million	19.4%	30.5%	24.0%	21.0%
$500 Million – $1 Billion	2.6%	0.2%	0.6%	2.2%
$1 – $10 Billion	40.3%	39.7%	49.9%	41.0%
>$10 Billion	0.0%	0.0%	0.0%	0.0%
All	100.0%	100.0%	100.0%	100.0%

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SOURCE: BANK CALL REPORTS
M.N.J May 26, 1994

ALL FDIC–INSURED COMMERCIAL BANKS SMALL BUSINESS C&I LOANS**
ARIZONA
AS OF JUNE 30, 1993
(Amounts in $ Millions)
ORIGINAL LOAN AMOUNT

B-4

Bank Asset Size	Original Loan Amount: Under $100,000	Original Loan Amount: $100,000 to $250,000	Original Loan Amount: $250,000 to $1,000,000	All Small Domestic C&I Loans	Total Domestic C&I Loans	As a % of All C&I Loans	Gross Domestic Loans	All Small C&I Loans As a % of Gross Domestic Loans	Total Assets	All Small Domestic C&I Loans As a % of Total Assets
<100 Million	23	15	22	60	145	41.4%	576	10.4%	987	6.1%
$100 – $250 Million	33	21	33	87	102	85.3%	558	15.6%	899	9.7%
$250 – $500 Million	41	37	60	138	247	55.9%	437	31.6%	775	17.8%
$500 Million – $1 Billion	2	1	3	6	29	20.7%	1,329	0.5%	1,508	0.4%
$1 – $10 Billion	107	72	163	342	1,053	32.5%	10,287	3.3%	21,136	1.6%
>$10 Billion	0	0	0	0	1,083	0.0%	7,025	0.0%	10,658	0.0%
All	206	146	281	633	2,659	23.8%	20,212	3.1%	35,963	1.8%

PERCENTAGES

Bank Asset Size	% Under $100,000	% of $100,000 to $250,000	% of $250,000 to $1,000,000	% of All Small C&I Loans	% of Total C&I Loans	% of Gross Loans	% of Total Assets
<100 Million	11.2%	10.3%	7.8%	9.5%	5.5%	2.8%	2.7%
$100 – $250 Million	16.0%	14.4%	11.7%	13.7%	3.8%	2.8%	2.5%
$250 – $500 Million	19.9%	25.3%	21.4%	21.8%	9.3%	2.2%	2.2%
$500 Million – $1 Billion	1.0%	0.7%	1.1%	0.9%	1.1%	6.6%	4.2%
$1 – $10 Billion	51.9%	49.3%	58.0%	54.0%	39.6%	50.9%	58.8%
>$10 Billion	0.0%	0.0%	0.0%	0.0%	40.7%	34.8%	29.6%
All	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

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SOURCE: BANK CALL REPORTS
M.N.J May 26, 1994

ALL FDIC–INSURED COMMERCIAL BANKS NUMBER OF SMALL BUSINESS C&I LOANS
CALIFORNIA
AS OF JUNE 30, 1993
ACTUAL NUMBER OF LOANS

B-5

Bank Asset Size	Number of Loans: Under $100,000	$100,000 to $250,000	$250,000 to $1,000,000	Number of All Small Domestic C&I Loans
<100 Million	20,457	3,449	1,800	25,706
$100 – $250 Million	26,154	4,432	2,910	33,496
$250 – $500 Million	14,960	2,699	1,807	19,466
$500 Million – $1 Billion	18,101	3,185	3,174	24,460
$1 – $10 Billion	23,948	3,779	3,679	31,406
>$10 Billion	123,843	6,889	5,143	135,875
All	227,463	24,433	18,513	270,409

PERCENTAGES

Bank Asset Size	% Under $100,000	% of $100,000 to $250,000	% of $250,000 to $1,000,000	% of All Small C&I Loans
<100 Million	9.0%	14.1%	9.7%	9.5%
$100 – $250 Million	11.5%	18.1%	15.7%	12.4%
$250 – $500 Million	6.6%	11.0%	9.8%	7.2%
$500 Million – $1 Billion	8.0%	13.0%	17.1%	9.0%
$1 – $10 Billion	10.5%	15.5%	19.9%	11.6%
>$10 Billion	54.4%	28.2%	27.8%	50.2%
All	100.0%	100.0%	100.0%	100.0%

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M.N.J May 26, 1994

ALL FDIC-INSURED COMMERCIAL BANKS SMALL BUSINESS C&I LOANS**
CALIFORNIA
AS OF JUNE 30, 1993
(Amounts in $ Millions)
ORIGINAL LOAN AMOUNT

B-6

Bank Asset Size	Original Loan Amount: Under $100,000	Original Loan Amount: $100,000 to $250,000	Original Loan Amount: $250,000 to $1,000,000	All Small Domestic C&I Loans	Total Domestic C&I Loans	As a % of All C&I Loans	Gross Domestic Loans	All Small C&I Loans As a % of Gross Domestic Loans	Total Assets	All Small Domestic C&I Loans As a % of Total Assets
<100 Million	457	371	490	1,318	1,776	74.2%	8,273	15.9%	12,572	10.5%
$100 – $250 Million	581	479	862	1,922	2,626	73.2%	11,528	16.7%	17,525	11.0%
$250 – $500 Million	333	299	587	1,219	1,880	64.8%	9,577	12.7%	14,366	8.5%
$500 Million – $1 Billion	464	390	784	1,638	2,620	62.5%	9,884	16.6%	17,501	9.4%
$1 – $10 Billion	457	414	1,180	2,051	6,614	31.0%	28,020	7.3%	43,164	4.8%
>$10 Billion	1,159	628	1,341	3,128	22,189	14.1%	123,775	2.5%	219,481	1.4%
All	3,451	2,581	5,244	11,276	37,705	29.9%	191,057	5.8%	324,609	3.5%

PERCENTAGES

Bank Asset Size	% Under $100,000	% of $100,000 to $250,000	% of $250,000 to $1,000,000	% of All Small C&I Loans	% of Total C&I Loans	% of Gross Loans	% of Total Assets
<100 Million	13.2%	14.4%	9.3%	11.7%	4.7%	4.3%	3.9%
$100 – $250 Million	16.8%	18.6%	16.4%	17.0%	7.0%	6.0%	5.4%
$250 – $500 Million	9.6%	11.6%	11.2%	10.8%	5.0%	5.0%	4.4%
$500 Million – $1 Billion	13.4%	15.1%	15.0%	14.5%	6.9%	5.2%	5.4%
$1 – $10 Billion	13.2%	16.0%	22.5%	18.2%	17.5%	14.7%	13.3%
>$10 Billion	33.6%	24.3%	25.6%	27.7%	58.8%	64.8%	67.6%
All	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

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SOURCE: BANK CALL REPORTS
M.N.J May 26, 1994

ALL FDIC–INSURED COMMERCIAL BANKS NUMBER OF SMALL BUSINESS C&I LOANS
WASHINGTON
AS OF JUNE 30, 1993
ACTUAL NUMBER OF LOANS

B-7

Bank Asset Size	Number of Loans Under $100,000	$100,000 to $250,000	$250,000 to $1,000,000	Number of All Small Domestic C&I Loans
<100 Million	4,961	557	212	5,730
$100 – $250 Million	6,516	651	400	7,567
$250 – $500 Million	3,736	299	115	4,150
$500 Million – $1 Billion	3,554	254	391	4,199
$1 – $10 Billion	22,887	2,740	2,173	27,800
>$10 Billion	43,938	1,842	2,360	48,140
All	85,592	6,343	5,651	97,586

PERCENTAGES

Bank Asset Size	% Under $100,000	% of $100,000 to $250,000	% of $250,000 to $1,000,000	% of All Small C&I Loans
<100 Million	5.8%	8.8%	3.8%	5.9%
$100 – $250 Million	7.6%	10.3%	7.1%	7.8%
$250 – $500 Million	4.4%	4.7%	2.0%	4.3%
$500 Million – $1 Billion	4.2%	4.0%	6.9%	4.3%
$1 – $10 Billion	26.7%	43.2%	38.5%	28.5%
>$10 Billion	51.3%	29.0%	41.8%	49.3%
All	100.0%	100.0%	100.0%	100.0%

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ALL FDIC–INSURED COMMERCIAL BANKS SMALL BUSINESS C&I LOANS**
WASHINGTON
AS OF JUNE 30, 1993
(Amounts in $ Millions)
ORIGINAL LOAN AMOUNT

B-8

Bank Asset Size	Original Loan Amount: Under $100,000	Original Loan Amount: $100,000 to $250,000	Original Loan Amount: $250,000 to $1,000,000	All Small Domestic C&I Loans	Total Domestic C&I Loans	As a % of All C&I Loans	Gross Domestic Loans	All Small C&I Loans As a % of Gross Domestic Loans	Total Assets	All Small Domestic C&I Loans As a % of Total Assets
<100 Million	97	65	57	219	414	52.9%	1,598	13.7%	2,603	8.4%
$100 – $250 Million	88	44	59	191	303	63.0%	1,172	16.3%	1,941	9.8%
$250 – $500 Million	58	31	33	122	191	63.9%	1,106	11.0%	2,040	6.0%
$500 Million – $1 Billion	36	31	57	124	171	72.5%	462	26.8%	788	15.7%
$1 – $10 Billion	637	287	615	1,539	4,019	38.3%	13,762	11.2%	17,930	8.6%
>$10 Billion	371	159	374	904	2,901	31.2%	12,027	7.5%	15,099	6.0%
All	1,287	617	1,195	3,099	7,999	38.7%	30,127	10.3%	40,401	7.7%

PERCENTAGES

Bank Asset Size	% Under $100,000	% of $100,000 to $250,000	% of $250,000 to $1,000,000	% of All Small C&I Loans	% of Total C&I Loans	% of Gross Loans	% of Total Assets
<100 Million	7.5%	10.5%	4.8%	7.1%	5.2%	5.3%	6.4%
$100 – $250 Million	6.8%	7.1%	4.9%	6.2%	3.8%	3.9%	4.8%
$250 – $500 Million	4.5%	5.0%	2.8%	3.9%	2.4%	3.7%	5.0%
$500 Million – $1 Billion	2.8%	5.0%	4.8%	4.0%	2.1%	1.5%	2.0%
$1 – $10 Billion	49.5%	46.5%	51.5%	49.7%	50.2%	45.7%	44.4%
>$10 Billion	28.8%	25.8%	31.3%	29.2%	36.3%	39.9%	37.4%
All	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

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SOURCE: BANK CALL REPORTS
M.N.J May 26, 1994

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Glossary

Bank Holding Company	A corporation that controls at least one bank.
Banking Company	One or many banks that belong to a single entity.
Community Bank	A banking company with less than $1 billion in banking assets.
Concentration Ratio	A measure of the amount of business handled by a specified number of the largest banking companies.
Banking Industry Consolidation	Banking industry consolidation is characterized by a greater concentration of assets among the largest banking companies within a local market, a state, or the nation.
De Novo	A new bank or branch office.
Herfindahl-Hirschman Index (HHI)	An index of concentration computed by summing the square of the market share of each firm in the industry.
Independent Bank	A bank that is not controlled by a bank holding company.
In-Market Merger	A merger between banks that operate in substantially overlapping markets.
Interstate Branching	An arrangement that permits banks to branch across state borders.
Limited Branching	An arrangement that restricts in-state bank branches, usually by number or by distance from where they are headquartered.
Market Extension Merger	A merger between banks that operate in minimally overlapping markets.
Nationwide Banking	An arrangement that permits bank holding companies to operate subsidiary banks in any state regardless of where the holding companies are headquartered.

Nationwide Reciprocal Banking

An arrangement whereby a state limits the entry of out-of-state bank holding companies to those states where its bank holding companies are permitted to enter.

Nonbank Subsidiary

Any business other than a commercial bank operated by a bank holding company.

Regional Reciprocal Banking

An arrangement whereby a state designates from which states it will permit the entry of bank holding companies. Entry is limited to banks from states within a specific region and is permitted only if those states offer reciprocity.

Reserve Bank

Any of the 12 district Federal Reserve Banks.

Statewide Branching

An arrangement that allows banks to operate a branch anywhere within a state.

Subsidiary

A separately chartered and regulated bank that is part of a bank holding company.

Unit Banking

An arrangement that prohibits banks from offering full services anywhere but their headquarters. Branching is not permitted.

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